TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1941

No. 61

HARRY F. MEILINK, AS TRUSTEE IN BANKRUPTCY OF THE ESTATE OF UNITED LAMP & SHADE CORPORATION, BANKRUPT, PETITIONER,

vs.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA

WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 28, 1941.

CERTIORARI GRANTED OCTOBER 13, 1941.

No. 9501

United States

Circuit Court of Appeals

For the Ninth Circuit.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,

Appellant,

vs.

HARRY F. MELINK, as Trustee in Bankruptcy of the Estate of UNITED LAMP & SHADE CORP., a Corporation, Bankrupt.

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

PARKER PRINTING COMPANY, 543 SANSOME STREET, SAN FRANCISCO

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the District Court of the United States, Northern District of California, Southern Division

No. 28590 S

In Bankruptcy

In the Matter of

UNITED LAMP AND SHADE CORP.,

a corporation,

Bankrupt.

AGREED STATEMENT OF CASE UNDER RULE 76

The Unemployment Reserves Commission has been and is a duly appointed and acting administrative agency of the State of California created by and exercising the powers conferred upon it by the public statute of the State of California known as Chapter 352 of the Statutes of 1935, as amended (Deering Act No. 8780d) also known as the Unemployment Reserves Act. Effective September 19, 1939, the title of said commission was changed to California Employment Commission (Chapter 1089, Stats. 1939), and the title of said Act was changed to Unemployment Insurance Act (Chapter 564, Statutes of 1939).

The United Lamp and Shade Corp., a corporation, was adjudicated a bankrupt under the provisions of the Federal Bankruptcy Act (Title 11, U. S. C.) on May 6, 1937, and Mr. Harry F. Meilink was duly appointed trustee. With respect to its

operations during the entire calendar year 1936, said corporation qualified as an employer subject to [1*] the contributory provisions of said Unemployment Reserves Act.

On September 15, 1937, there was filed in the above entitled bankruptcy proceedings on behalf of said Unemployment Reserves Commission a proof of priority claim for taxes in the amount of $822.40 together with interest thereon at the rate of 12 per cent per annum. A copy of said proof of priority claim is attached hereto marked "Exhibit A" and is incorporated herein by reference. On or about February 23, 1939, the trustee paid to said Unemployment Reserves Commission the sum of $936.35 in payment of the principal of said priority claim, with interest thereon at the rate of 6 per cent per annum.

Section 45 of said Unemployment Reserves Act (Chap. 352, Statutes of 1935) read as follows:

> "If any employer defaults in any payment required of him, for himself or on behalf of employees under this Act, he shall become additionally liable for interest on such payments at the rate of twelve per cent per annum from the date such payment becomes due, both principal and interest being payable in the same manner as the contributions. Such payment and interest shall be collectible in the name of the fund in any manner practicable, including civil action

*Page numbering appearing at foot of page of original certified Transcript of Record.

by the commission against the defaulting employer."

The rate of interest on delinquent contributions as provided for in said Section 45 remained unchanged until September 19, 1939, at which time said rate of interest was changed to one per cent per month or fraction thereof (Chap. 630, Stats. 1939). [2]

On or about March 30, 1939, there was filed on behalf of the said trustee in bankruptcy a verified objection to the proof of priority claim filed on behalf of said Unemployment Reserves Commission. A copy of said written objection is attached hereto marked "Exhibit A(1)" and is incorporated herein by reference. In said objection it was alleged, in substance, that said trustee has paid the principal amount of said claim with interest thereon at the rate of 6 per cent per annum, that interest at the rate of 12 per cent per annum constitutes a penalty within the purview of Section 57j of the Bankruptcy Act (11 U. S. C. A., P. 93j); and that said trustee refuses the payment of any interest in excess of the rate of six per cent per annum.

Thereafter, counsel representing the interested parties submitted authorities in support of their respective contentions. On November 18, 1939, Hon. Burton J. Wyman, Referee in Bankruptcy, issued his opinion and order, sustaining the objection of the trustee that interest at 12 per cent per annum constitutes a penalty, but requiring the trustee to pay to said Unemployment Reserves Commission

an additional one per cent per annum. A copy of said opinion and order of the Referee is attached hereto marked "Exhibit B" and is incorporated herein by reference.

Thereafter, on November 27, 1939, and within the time provided by law, there was filed on behalf of said Unemployment Reserves Commission a verified petition to review order [3] of referee. A copy of said petition to review is attached hereto marked "Exhibit C" and is incorporated herein by reference.

Thereafter, on February 9, 1940, said referee filed with the Clerk of the above entitled Court a Certificate and Report of the Referee on Petition of Unemployment Reserves Commission of the State of California to Review Order of Referee. In order to avoid repetition, a copy only of that portion of said Certificate and Report entitled "Supplemental Decision By And Opinion of Referee" is attached hereto marked "Exhibit D" and is incorporated herein by reference.

The matter came on regularly before the above entitled Court on February 19, 1940, at which time counsel for the interested parties agreed to submit the matter on the record and briefs. The brief on behalf of the Unemployment Reserves Commission was duly filed February 28, 1940, and the brief on behalf of the trustee was duly filed on March 5, 1940.

Thereafter, on March 18, 1940, the above entitled Court made and entered its Order approving and

confirming the Certificate and Report of the Referee and the Order of the Referee dated November 18, 1939. A copy of said Order is attached hereto marked "Exhibit E" and incorporated by reference herein. [4]

Respectfully submitted,
EARL WARREN,
Attorney General of the State of California
JOHN J. DAILEY,
Deputy
MAURICE P. McCAFFREY
GLENN V. WALLS
By MAURICE P. McCAFFREY
Counsel for Unemployment Reserves Commission of the State of California,
Petitioner and Appellant

Approved by
DINKELSPIEL & DINKELSPIEL
GRANT H. WREN
Attorneys for Trustee

Approved, this 18 day of April, 1940.
A. F. ST. SURE

Receipt of a copy hereof is acknowledged the 18th day of April, 1940.
DINKELSPIEL & DINKELSPIEL
GRANT H. WREN
Attorneys for Trustee [5]

EXHIBIT A

[Title of District Court and Cause.]

PROOF OF PRIORITY CLAIM FOR TAXES

Employer's Registration No. 1B-2996

On the 14th day of September, 1937, came Forrest M. Hill and made oath and said:

1. That he is one of the authorized and acting agents of the California Unemployment Reserves Commission, and as such he is qualified and empowered to make this claim on behalf of the said Commission;

2. That he is informed and believes the said United Lamp & Shade Corporation, Bankrupt, was, at or before the filing of the bankruptcy petition, and is now justly and truly indebted to the State of California in the sum of eight hundred twenty-two 40/100 Dollars ($822.40);

3. That the consideration of the debt is a tax duly levied and assessed under the provisions of the California Unemployment Reserves Act (Stats. 1935, Chapter 352), and interest itemized as follows:

12% per annum on $324.00 from August 1, 1936, to date of payment [6]

12% per annum on $180.24 from November 1, 1936, to date of payment

12% per annum on $318.16 from January 21, 1937, to date of payment

4. That this claim is entitled to the PRIORITY provided by Sec. 64-a of the Bankruptcy Act;

5. That the due date for the said tax is past;

that no part of the said tax has been paid except as above stated; that there are no set-offs or counterclaims to the same; that no note or judgment has been recovered therefor; that deponent has not, nor has any person, to his knowledge or belief, for the use or benefit of the State of California, had or received any manner of security for the said tax or interest or penalty whatever, EXCEPT as follows:

Subscribed and sworn to before me this 14th day of September, 1937.

AMY B. WARNER

Notary Public in and for the County of Sacramento, State of California.

FORREST M. HILL

Unemployment Reserves Commission

Make all checks payable to California Unemployment Reserves Commission at Sacramento, California. [7]

EXHIBIT A(1)

[Title of District Court and Cause.]

TRUSTEE'S OBJECTION TO PRIORITY TAX CLAIM

To the Honorable the District Court of the United States for the Northern District of California and to Burton J. Wyman, Esq., Referee in Bankruptcy at San Francisco, California:

Now comes your petitioner, Harry F. Meilink, and respectfully represents:

That he is the duly qualified and acting Trustee

of the above named bankrupt corporation;

That California Unemployment Reserves Commission has filed its Proof of Claim in the above proceeding demanding priority in payment of the sum of $822.40 and interest at the rate of 12% per annum thereon to date of payment;

That your petitioner has paid the principal amount of said Proof of Claim and interest thereon at the rate of 6% per annum as the reasonable and customary rate of interest for the forbearance of any sum of money owed a creditor;

That said creditor predicates its demand for interest at the rate of 12% per annum pursuant to the provisions of Chapter [8] 352 of the 1935 Statutes of California, Section 45, making an employer defaulting in payments required by him under said Statute additionally liable for interest on such payments at the rate of 12% per annum;

That upon the ground that a demand for the payment of interest at 12% per annum constitutes a penalty within the purview of Section 57j of the Bankruptcy Act your petitioner refused to make payment of any sum in excess of 6%;

Wherefore, your objecting Trustee prays that the Proof of Claim of said California Unemployment Reserves Commission be reconsidered and that upon the hearing of the within Objection that an Order be made and entered disallowing payment of interest on the said sum of $822.40 in excess of 6% per annum on said amount.

HARRY F. MEILINK
Objecting Trustee [9]

State of California,
City and County of San Francisco—ss.

Harry F. Meilink, being duly sworn, deposes and says:

That he is the petitioner named in the foregoing Objection to Priority Tax Claim; that he has read said Objection and that the same is true to the best of his knowledge and belief.

.....

Subscribed and Sworn to before me this ..... day of March, 1939.

.....

Notary Public in and for the City and County of San Francisco, State of California. [10]

EXHIBIT B

[Title of District Court and Cause.]

OPINION AND ORDER ON TRUSTEE'S OBJECTION TO PROOF OF PRIORITY CLAIM FOR TAXES FILED BY UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA.

A proof of priority claim for taxes was filed herein by the Unemployment Reserves Commission of the State of California, represented by Hon. Earl Warren, Attorney General, Albert F. Zangerle, Deputy, Maurice P. McCaffrey and Samuel L. Gold. In the claim it is alleged, in substance, that the

bankrupt estate herein is justly and truly indebted to said state in the sum of $822.40. The alleged "consideration of the debt is a tax duly levied and assessed under the provisions of the California Unemployment Reserves Act (Stats. 1935, Chapter 352), and interest, itemized as follows, [11] 12% per annum on $324.00 from August 1, 1936 to date of payment, 12% per annum on $180.24 from November 1, 1936 to date of payment, and 12% per annum on $318.16 from January 21, 1937 to date of payment," it being further alleged in said claim,

"That this claim is entitled to the PRIORITY provided by Sec. 64-a of the Bankruptcy Act."

The trustee in bankruptcy herein, represented by Grant H. Wren, Esq., assisted by James M. Conners, Esq., and Messrs. Dinkelspiel & Dinkelspiel, meets this claim with a written objection wherein it is alleged, in substance, that said trustee has paid the principal amount of said claim with interest thereon at the rate of 6% per annum as the reasonable and customary rate of interest for the forbearance of any sum owed a creditor and that interest at the rate of 12% per annum constitutes a penalty within the purview of Section 57j of the Bankruptcy Act. (11 USCA, (93j), and hence said trustee refuses the payment of any interest in excess of the 6% per annum on said amounts, paid as aforesaid. The facts being undisputed, the matter resolves itself into a pure legal question based for the most part on statutory construction.

So much of Section 64-a of the Bankruptcy Act (11 USCA, (104-a), as is necessary to this discus-

sion provides, "The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality, in the order of priority as set forth in paragraph (b) hereof * * *", the pertinent part of [12] paragraph (b) adding, "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be * * * (6) taxes payable under paragraph (a) hereof * * *"

Section 57j of the Bankruptcy Act (11 USCA. (93-j), upon which, supported by certain decisions, the trustee relies for the soundness of his contention, declares, "Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

Section 45 of the statute upon which the State of California basically relies for the authority to collect the claimed amounts, provides, "If any employer fails to make any payment required of him, or fails to deduct and pay to the commission the contributions of his workers, in accordance with the provisions of this act and of the rules and regulations adopted by the commission, he shall become additionally liable for interest on such payments at

the rate of twelve per cent per annum from the date such payment becomes due, both principal and interest being payable in the same manner as the contributions. Such payment and interest shall be collectible in the name of the commission [13] in any manner practicable, including civil action by the commission against the defaulting employer."

With the above cited sections of the Bankruptcy Act and the section of the applicable law of the State of California before it, this court must determine whether or not any portion of the claimed 12% is a penalty. In so doing, the court must, of necessity, deal with property rights belonging to said bankrupt estate, and "* * * where", as was said in Board of Trade of City of Chicago v. Johnson, 264 U. S. 1, 10, 44 S. Ct. 232, 234, 68 L. Ed. 533, 536, "the Bankrupt Law deals with property rights which are regulated by the state law, the federal courts in bankruptcy will follow the state courts * * *."

Recognizing the rule just cited as being binding upon the court in this proceeding, I am of the opinion that, as to whether or not the "12% interest" is in fact "interest" or a "penalty", the answer to the question is to be found in Powell v. Allan,* 70 Cal. App. 663, 672, 234 Pac. 339, 343. In that case, it was said, "Where, under the guise of 'in-

*PETITION TO HAVE CAUSE HEARD IN SUPREME COURT OF CALIFORNIA DENIED.

terest', a sum is exacted of a DELINQUENT† property owner, such sum, though denominated 'interest', is in fact a penalty—as was held in the Oregon supreme court in Colby v. Medford, 85 Or. 485 (167 Pac. 487). There the court said that 'when interest is charged on a delinquent tax, it is not regarded as interest in the sense that it is a consideration for the [14] forbearance of money, but it is deemed to be a penalty.' "‡

Accepting and following the holdings of the highest courts of the State of California that the charges for so-called "interest" in statutes of the character of the state statute here under consideration are in fact and in law "penalties", yet, under the provisions of Section 57j of the Bankruptcy Act (11 USCA, (93-j), this court can, and should, allow "the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose * * *", which, upon the record presented herein, I am of the opinion ought not to exceed the legal rate of interest in the State of California, i. e., "seven dollars upon the one hundred dollars for one year and at that rate for a greater or less sum or for a longer or shorter time * * *" LXXXIII, 1919 Stat. To hold otherwise as regards both the penalty and compensation-for-pecuniary-loss theory hereinbefore set forth, in my opinion, would be violative of a well recognized

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†Emphasis in this Opinion Referee's.

‡Copy of Attorney General's opinion of April 27, 1939, omitted.

rule, i. e., "In the construction of a statute it is assumed that the legislature knew the existing laws, and that it had knowledge of existing judicial decisions, and enacted statutes in the light of such decisions as have a direct bearing upon them." Robertson v. Longford, 95 Cal. App. 414, 424, 273 Pac. 150, 153, 154. [15]

Ordered: (1) That insofar as the trustee objects to the payment of any penalty is concerned, said objection, except as hereinafter provided, may be, and it is SUSTAINED, (2) that insofar as the trustee objects to making any payment upon said claim in excess of the 6% per annum is concerned, said objection may be, and it is, OVERRULED, and (3) that said trustee is hereby directed to, and he will, pay to the Unemployment Reserves Commission on behalf of the State of California, the additional one per cent per annum on the three amounts set forth in the proof of priority claim, as to which said amount of one per cent per annum ONLY said priority claim is hereby ALLOWED, said claim being hereby DISALLOWED in all other particulars.

Dated: November 18, 1939.

BURTON J. WYMAN
Referee in Bankruptcy

[Endorsed]: Filed Nov. 18, 1939. Burton J. Wyman, Referee in Bankruptcy, Special Master. [16]

EXHIBIT C

[Title of District Court and Cause.]

PETITION TO REVIEW ORDER OF REFEREE

To the Honorable, Burton J. Wyman, Referee in Bankruptcy:

The petition of your petitioner respectfully shows as follows:

That petitioner, Unemployment Reserves Commission of the State of California, is a creditor of the estate of United Lamp & Shade Corporation, the above named bankrupt; that petitioner filed a proof of priority claim for taxes under Section 64-a of the Bankruptcy Act, (11 U. S. C. A. 104-a), showing that the bankrupt estate is indebted to petitioner in the sum of $822.40, together with interest itemized as follows, 12% on $324.00 from August 1, 1936, to date of payment, 12% per annum on $180.24 from November 1, 1936, to date of payment, 12% per annum on $318.16 from January 21, 1937, to date of payment; [17]

That the trustee in bankruptcy paid the principal sum of said claim with interest thereon at 6% per annum;

That in the course of the proceedings on the 18th day of November, 1939, an order was made disallowing interest on petitioner's claim in excess of seven per cent per annum, and ordering trustee to pay an additional one per cent per annum to that of the six per cent per annum already paid;

That the order complained of is as follows:

> "Ordered: (1) That insofar as the trustee objects to the payment of any penalty is concerned, said objection, except as hereinafter provided, may be, and it is, SUSTAINED, (2) that insofar as the trustee objects to making any payment upon said claim in excess of the 6% per annum is concerned, said objection may be, and it is, OVERRULED, and (3) that said trustee is hereby directed to, and he will, pay to the Unemployment Reserves Commission on behalf of the State of California, the additional one per cent per annum on the three amounts set forth in the proof of priority claims, as to which said amount of one per cent per annum ONLY said priority claim is hereby ALLOWED, said claim being hereby DISALLOWED in all other particulars."

That it is respectfully submitted such order was and is erroneous, in that petitioner's claim for interest should have been allowed in the full amount of twelve per cent per annum, and that the trustee should have been ordered to pay the additional sum of six per cent per annum to that of the six per cent per annum already paid, by virtue of the fact that the amount of interest claimed in excess of seven per cent per annum is not a penalty, but interest, and designated as such in the California Unemployment Reserves Act. [18]

See:

United States vs. Childs, 266 U. S. 304, 5 A. B. R. (NS) 5

Horn vs. Boone County, 44 F. 2nd 920, 16 A. B. R. (NS) 615

In re Beardsley and Wolcott Mfg. Co., 82 F. 2nd 239, 31 A. B. R. (NS) 33

Also see recent annotation on this subject appearing in Volume 104, A. L. R., at page 881.

Wherefore, your petitioner, feeling aggrieved because of such order, prays that the same may be reviewed, as provided in Section 39(c) of the Federal Bankruptcy Act.

Dated: November 25, 1939.

EARL WARREN,
Attorney General
ALBERT F. ZANGERLE,
Deputy
MAURICE P. McCAFFREY
SAMUEL L. GOLD,
Of Counsel,
By SAMUEL L. GOLD
Attorneys for Petitioner

State of California,
County of Sacramento—ss.

Samuel L. Gold, being first duly sworn, deposes and says:

That he is one of the attorneys for the petitioner herein, and that he has read the foregoing petition

for review, and that the contents thereof are true of his own knowledge, except as to such matters as are therein stated on information and belief, and as to such matters he believes them [19] to be true.

SAMUEL L. GOLD

Subscribed and sworn to before me, this 25th day of November, 1939.

[Seal] AMY B. WARNER

Notary Public in and for the County of Sacramento, State of California. [20]

EXHIBIT D

[Title of District Court and Cause.]

CERTIFICATE AND REPORT OF REFEREE ON PETITION OF UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA TO REVIEW ORDER OF REFEREE.

To Honorable A. F. St. Sure, United States District Judge for the Northern District of California:

I, Burton J. Wyman, one of the referees in bankruptcy of this court and the referee in charge of this bankruptcy proceeding, respectfully certify and report:

* * * * * * *

Supplemental Discussion By and Opinion of Referee

I. The only point made in the petition for review is "that petitioner's claim for interest should

have been allowed in the full amount of twelve per cent per annum, and that the trustee should have been ordered to pay the additional sum of six per cent per annum to that of the six per cent already paid, BY VIRTUE OF THE FACT THAT THE AMOUNT OF INTEREST CLAIMED IN EXCESS OF SEVEN PER CENT PER ANNUM [21] IS NOT A PENALTY, BUT INTEREST, AND DESIGNATED AS SUCH IN THE CALIFORNIA UNEMPLOYMENT INSURANCE ACT."*

The answer to such contention is simple: Merely because the legislature of the State of California saw fit to use the word "interest" to designate the additional amount made payable under certain conditions provided for in the statute under discussion herein, does not, in anywise, bind a federal court so to interpret the word if, in fact, the legislature has given a misnomer to said amount, considered as a whole, or in part. As was said by the Supreme Court of the United States, in discussing the distinction between a "tax" and a "penalty", United States v. LaFranca, 282 U. S. 568, 572, 51 S. Ct. 278, 280, 75 L. Ed. 551, 555, "No mere exercise of the art of lexicography can alter the essential nature of the act or thing; and if an exaction be clearly a penalty it cannot be converted into a tax by the simple expedient of calling it such," which is but another way of declaring the rule announced by the court in Powell v. Allan, supra.

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*Emphasis referee's.

II. In citing United States v. Childs, 266 U. S. 304, 45 S. Ct. 110, 69 L. Ed. 299, Horn v. Boone County, 44 F. (2d) 920, In re Beardsley & Wolcott Mfg. Co., 82 F. (2d) 239, counsel for the petitioner for review seemingly have overlooked the rule found in Wright v. Nagle, 101 U. S. (XI Otto) 791, 796, 797, 25 L. Ed. 921, 923, i. e., "The language of the court in the opinion is to be construed with reference to [22] the question actually under consideration, and should not be extended beyond for any purpose of authority in another and different case,"—a rule which is consistently followed by federal courts when considering the applicability of the language of former decisions to the facts involved in the cases then before them. Nothing is more certain than is the fact that in none of the cases cited by counsel in support of the petition for review was the court dealing with a question involving the acts or language of a legislative body so limited in its authority as was the legislature of the State of California when it purported to fix an interest rate of twelve per cent per annum WITHOUT THE AGREEMENT OF THOSE AGAINST WHOM SUCH AN INTEREST RATE LAWFULLY COULD BE CHARGED.

"Interest is the compensation allowed by law or FIXED BY THE PARTIES* for the use, or forbearance, or detention of money." California Civil Code, Sec. 1915. "The rate of interest upon the

*Emphasis referee's.

loan or forbearance of any money, goods or things in action or on accounts after demand or judgments rendered in any court of this state, shall be SEVEN DOLLARS UPON THE ONE HUNDRED DOLLARS FOR ONE YEAR* and at that rate for a greater or less sum or for a longer or a shorter time; BUT IT SHALL BE COMPETENT FOR PARTIES TO CONTRACT FOR THE PAYMENT AND RECEIPT OF A RATE OF INTEREST NOT EXCEEDING TWELVE DOLLARS ON ONE HUNDRED DOLLARS FOR ONE YEAR* and not exceeding that rate for a greater or less sum or for a longer [23] or shorter time, IN WHICH CASE SUCH RATE EXCEEDING SEVEN DOLLARS ON ONE HUNDRED DOLLARS SHALL BE CLEARLY EXPRESSED IN WRITING."* LXXXIII, 1919 Stat. It therefore follows that while an interest rate not to exceed twelve per cent per annum lawfully could be fixed by the parties affected thereby, no legal rate of interest can be fixed by the legislature of the State of California in excess of seven per cent per annum, without the agreement of all parties concerned. Consequently, when such legislature undertook to establish the twelve per cent rate, in the absence of an agreement on the part of those affected by such higher rate, the legislative act was an attempt to amend the above cited statute, adopted by the people of the State of California in the exercise of their constitutional initia-

*Emphasis referee's.

tive power. In the language of Penziner v. West American Finance Co., 10 Cal. (2d) 160, 171, 74 Pac. (2d) 252, 257, "It should be here mentioned that the usury law was adopted as an initiative measure and inasmuch as it contains no provision permitting its amendment by the legislature, the act can be amended or repealed only 'by a vote of the electors.' (California Constitution, art. IV, sec. 1.)"

While a ruling of this nature may seem startling, at first glance, its only effect is to curtail the percentage of interest which can be collected under the Bankruptcy Act, under the conditions present herein. However, the State of [24] California, in the administration of its own affairs, without the jurisdiction of the bankruptcy court, is not thus handicapped, inasmuch as "the power of the legislature in matters of taxation is unlimited, except as restricted by constitutional provisions." In re Madera Irrigation District, 92 Cal. 296, 324, 28 Pac. 272, 279. Hence, regardless of whether the sum added over and above the tax proper be called, or in fact be, "interest" or "penalty", no person concerned, unless bankruptcy has intervened, can be heard to complain, for the reason that ". . . the imposing of penalties for the nonpayment of a tax is a legislative function . . ." Ducey v. Dambacher, 24 Cal. App. (2d) 429, 433, 75 Pac. (2d) 98, 100.

III. In the light of the foregoing rulings by the highest courts of the State of California, it is interesting to note the careful discrimination in the

use of words in the letter of the state attorney general, above quoted in its entirety, wherein this twelve per cent rate was referred to as "the interest penalty". Moreover, it is not amiss to add that the careful choice of words in this regard also shows a familiarity with at least one set of statute-qualifying decisions by the state's highest courts which, so far as this particular subject is concerned, speaks volumes for the efficiency of those entrusted with the performance of the important duties resting upon the shoulders of California's Attorney General and his assistants. [25]

Papers Handed Up Herewith

I hand up herewith the following papers:

1. Proof of Priority Claim for Taxes;
2. Trustee's Objection to Priority Tax Claim;
3. Opinion and Order on Trustee's Objection to Proof of Priority Claim for Taxes Filed by Unemployment Reserves Commission of the State of California; and
4. Petition to Review Order of Referee.

Dated: February 9th, 1940.

Respectfully submitted,

BURTON J. WYMAN

Referee in Bankruptcy. [26]

EXHIBIT E

[Title of District Court and Cause.]

ORDER

Ordered that the "Certificate and Report of Referee on Petition of Unemployment Reserves Commission of the State of California to Review Order of Referee," filed herein on February 9, 1940; and the Referee's order of November 18, 1939, as to which the review is sought, be and the same are hereby Approved and Confirmed.

Dated: March 18, 1940.

A. F. ST. SURE
United States District Judge.

[27]

[Title of District Court and Cause.]

STATEMENT OF POINTS TO BE RELIED ON BY UNEMPLOYMENT RESERVES COMMISSION, APPELLANT.

1. That the Referee in the above entitled bankruptcy proceedings erred in sustaining the objection of the trustee that interest at the rate of twelve per cent per annum on delinquent contributions or taxes included in the proof of priority claim of the Unemployment Reserves Commission pursuant to Section 45 of the Unemployment Reserves Act constituted a penalty in bankruptcy within the purview of Section 57j of the Bankruptcy Act (Title 11, U.S.C. P. 93j).

2. That the Referee in the above entitled bankruptcy proceedings erred in failing to order the trustee to pay to the Unemployment Reserves Commission on behalf of the State of California the full amount of interest included in said proof of priority claim of said Unemployment Reserves Commission.

3. That the District Court erred in approving and confirming the "Certificate and Report of Referee on Petition of Unemployment Reserves Commission of the State of [28] California to Review Order of Referee" as filed on February 9, 1940, and the Referee's order dated November 18, 1939.

Respectfully submitted,
EARL WARREN,
Attorney General of the State of California
JOHN J. DAILEY,
Deputy
MAURICE P. McCAFFREY
GLENN V. WALLS
By MAURICE P. McCAFFREY
Counsel for Unemployment Reserves Commission,
Appellant

[Endorsed]: Filed Apr. 18, 1940. Walter B. Maling, Clerk.

[Title of Cause.]

United States of America
Northern District of California
City and County of San Francisco—ss.

I, Walter B. Maling, Clerk of the United States District Court for the Northern District of California, do hereby certify the foregoing to be a full, true, and correct copy of the original Agreed Statement of Case Under Rule 76, filed Apr. 18, 1940, in the above-entitled cause, as the same remains of record and on file in the office of the Clerk of said Court.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court this 19th day of April A. D. 1940.

[Seal] WALTER B. MALING
Clerk of the United States District Court, Northern District of California.

By J. P. WELSH
Deputy Clerk. [29]

[Endorsed]: No. 9501. United States Circuit Court of Appeals for the Ninth Circuit. Unemployment Reserves Commission of the State of California, Appellant, vs. Harry F. Meilink, as Trustee in Bankruptcy of the Estate of United Lamp & Shade Corp., a Corporation, Bankrupt, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed April 19, 1940.

PAUL P. O'BRIEN,

Clerk, United States Circuit Court of Appeals for the Ninth Circuit.

At a Stated Term, to wit: The October Term A. D. 1939, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Monday the twenty-second day of April in the year of our Lord one thousand nine hundred and forty.

Present:

Honorable Francis A. [illegible]arrecht, Circuit Judge, Presiding,

Honorable Bert Emory Haney, Circuit Judge,

Honorable William Healy, Circuit Judge.

No. 9501

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,

Appellant,

vs.

HARRY F. MEILINK, As Trustee in Bankruptcy,

Appellee.

ORDER ALLOWING APPEAL

Upon consideration of the petition for allowance of appeal, filed April 18, 1940, and good cause therefor appearing, It Is Ordered that the petition be, and hereby is granted;

It Is Further Ordered that the appellant present for approval and filing bond in the sum of $250.00 within 10 days from date. [30]

No. 9501

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,

Appellant,

vs.

HARRY F. MEILINK, as Trustee in Bankruptcy of the Estate of UNITED LAMP & SHADE CORP., a Corporation, Bankrupt,

Appellee.

Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division

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PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

PARKER PRINTING COMPANY, 549 SANSOME STREET, SAN FRANCISCO

United States Circuit Court of Appeals
for the Ninth Circuit

Excerpt from Proceedings of Wednesday, November 13, 1940.

Before: Wilbur, Garrecht and Healy,
Circuit Judges.

[Title of Cause.]

ORDER OF SUBMISSION

Ordered appeal in above cause argued by Mr. Glenn V. Walls, counsel for appellant, and by Mr. James M. Connors, counsel for appellee, and submitted to the court for consideration and decision.

United States Circuit Court of Appeals
for the Ninth Circuit

Excerpt from Proceedings of Thursday, December 12, 1940.

Before: Wilbur, Garrecht and Healy,
Circuit Judges.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF DECREE.

By direction of the Court, Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the clerk, and that a decree be filed and recorded in the minutes of this court in accordance with the opinion rendered.

[Title of Circuit Court of Appeals and Cause.]

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

OPINION

Before: Wilbur, Garrecht and Healy, Circuit Judges.

Wilbur, Circuit Judge:

This is an appeal from an order of the bankruptcy court denying a claim for a portion of the interest included in the appellant's claim for taxes or "contributions" to unemployment reserves and for interest thereon due to it as an agency of the state of California. The amount of the "contribution" by the appellant was $822.40 in 1937. The trustee paid $936.35, principal and interest, on February 13, 1939. The amount of unpaid interest (5%) was $156.00. The trustee filed objections to the claim of priority for the balance of the unpaid interest (6%) which he objected to on the ground that it constituted a penalty within the meaning of §57 (j) of the Bankruptcy Act (11 U. S. C. A. §93 (j)) prohibiting approval of claims of states for penalties in greater amounts than the loss incurred by the debtor's default.[1] The referee in bank-

[1]Sec. 57 (j) of the Bankruptcy Act (11 U. S. C. A. §93 (j)): "Debts owing to the United States or to any state or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act,

ruptcy sustained the objection of the trustee as to five per cent but allowed one per cent additional, making the total allowance of seven per cent on said overdue "contributions", or taxes. The District Court affirmed the order of the referee and this court allowed the appeal, the amount of interest involved being less than $500. (28 U. S. C. A. §24 (a), 30 (a).

The California statute fixing the tax, or "contribution" (Cal. Stats. 1935, ch. 352, §45; Deerings General Laws of 1937, Act 8780 (d)) provides for the payment of interest thereon as follows:

"If any employer fails to make any payment required of him, or fails to deduct and pay to the commission, the contributions of his workers in accordance with the provisions of this act, and of the rules and regulations adopted by the commission, he shall become additionally liable for interest on such payments at the rate of 12% per annum from the date such payment becomes due, both principal and interest being payment in the same manner as the contribution. Such payment and interest shall be collectible in the name of the Commissioner in any manner practicable, including civil action by the Commissioner against the defaulting employer."

There is no justification on the face of the California statute for treating the 12% as anything other than interest. It is so characterized in the

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transactions, or proceedings out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

statute and the amount payable depends upon the lapse of time between the accrual of the obligation and its payment, which lies wholly in the control of the taxpayer. The Supreme Court, in the case of United States v. Childs, 266 U. S. 304, had occasion to construe the provisions of the Bankruptcy Act (§57 (j), 11 U. S. C. A. §93 (j)) with reference to the allowance of interest upon income taxes which was claimed to be excessive and therefore a penalty. The United States statute imposing the income tax (Sec. 14 (a) T. I., part II, Revenue Act 1916) there under consideration, provided that: "* * * after ten days' notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due."

The government conceded that the five per cent charge was a penalty and, consequently, was not payable by the bankrupt's estate, but it urged its claim for the charge of one per cent per month as interest. The referee therein had held that the one per cent per month interest, as well as the five per cent charge, was a penalty and, therefore, was not a claim which could be allowed against the estate under the provisions of §57 (j) of the Bankruptcy Act. He allowed six per cent interest only. The District Court and the Circuit Court of Appeals affirmed this order for the same reason but the Supreme Court reversed its decision and held that the government was entitled to have its claim allowed

for the one per cent per month designated as interest on the revenue law imposing the tax (§14a, supra). In ruling upon the question the court said: "A penalty is a means of punishment; interest a means of compensation. Bouvier defines it to be 'a consideration paid for the use of money or for forbearance in demanding it when due.'

"The imposition of a tax is certainly a function of government and creates an obligation, and the power that creates the obligation can assign the measure of its delinquency—the detriment of delay in payment; and §14 (a) has done so in this case, and explicitly done so. Five per centum penalty is the cost of delinquency, and interest upon the amount due at 1% per month—12% a year. There is no ambiguity in the declaration nor the distinction made. * * * The Circuit Court of Appeals considered that the 1% was involved as well, as being in effect penalty and not saved by its name, though it was imposed by the legislature and within the legislative power, and notwithstanding that taxes are treated as debts within the meaning of the Bankruptcy Act. * * *

"The Circuit Court of Appeals adjudged the tax in the present case a debt and assigned against it interest at 6%; the court considering that that interest was compensation for the delinquency, anything in excess becoming penalty and within the prohibition of §57-j. The court said, 'On the point at bar [one per cent interest as the price of the delay being penalty] we are in accord with Re Ashland, etc.,

229 Fed. 829, and hold that there being no evidence of any injury or damage to the government by the withholding of this tax except that which flows from the non-payment of a just debt, anything in excess of the legal rate of interest is to be treated as a penalty and not allowed.'

"We are unable to concur. It makes the rate of interest that of a particular locality, differing with the locality—in New York, as said by the government, 6%, in the middle West 8% and on the Pacific coast 10%,—and abridges or controls a federal statute by a local law or custom, and takes from it uniformity of operation. Besides, the federal statute is precise, and it is made peremptory by the distinction between 'penalty' and 'interest', and if it may be conceded that the use of the latter word would not save it from condemnation if it were in effect the former, it cannot be conceded that 1% per month—12% a year—gives it that illegal effect, certainly not against legislative declaration that is within the legislative power, there being no ambiguity to resolve." The Supreme Court also pointed out that its decision was not inconsistent with its prior decision in New York v. Jersawit, 263 U. S. 493, relied upon by the appellee herein, in that the statute of New York there involved required the corporation to pay the tax plus 10% thereof, plus one per cent per month "for each month the tax remains unpaid". It was there held that the monthly installments must be added to the 10% penalty and must be treated as a part of one corpus and must

fall with it. After pointing out these distinctions the court added: "The tax in this case is one on income; a burden imposed for the support of the government. Interest is put upon it and so denominated, distinguished from the 5% as penalty, clearly intended to compensate the delay in the payment of tax—the detriment of its non-payment, to be continued during the time of its non-payment—compensation, not punishment."

It will be observed that the reasons advanced by the Supreme Court in support of the 12% as a charge of interest and not penalty, were two-fold: first, the matter lay within the legislative power of the government to fix a rate of interest to be charged upon delinquent taxes; and second, that to construe the bankruptcy act so as to permit this statutory rate to be ignored would result in the substitution of a rate which was dependent in each case upon the value of the use of money in the different localities. Both arguments apply with equal force to the 12% interest charge fixed by the legislature of the state of California in the instant case. It is expressly stated to be a rate of interest to be charged and computed as such. To fix a rate of interest other than that fixed by law would be a departure from the legislative mandate in the sphere in which the legislature is supreme. It would also result in equality for not only might a different rate be fixed in different communities in California, but different rates might be fixed in the same community by different referees in bankruptcy or by the same referee

if in his judgment the value of the use of money had fluctuated from time to time in the community in which he was exercising his judicial functions. This decision of the Supreme Court (U. S. v. Childs, supra) has been construed and applied by a number of the Circuit Courts of Appeals.

In the case of In re Semon, 80 F. 2d 81, the Second Circuit had occasion to pass upon the question of the right of the United States to recover 12% as interest upon unpaid income taxes due the government of the United States from the bankrupt. It was sought by the trustee in bankruptcy to distinguish the question there involved from the prior decision of the Supreme Court in United States v. Childs, supra, by pointing out that under later amendments of the Revenue Act different and lesser rates of interest were fixed for other delinquencies. In reply the court pointed out that a similar argument might have been made in United States v. Childs, supra, because of the fact that the statute there under consideration, in dealing with estate taxes (§§204, 207, 39 Stats. 778, 779) provided for interest at varying rates, but the court said: "We are not persuaded that when Congress prescribes different rates of interest for different delinquencies in payment of taxes, the higher rate must necessarily be deemed to include a penalty. Since the higher rate is one within the legislative power to prescribe as interest (United States v. Childs, supra), it may well be argued that Congress regards the higher rate as the normal compensation for de-

lay in payment under the circumstances where it obtains, although willing to accept a lesser compensation for delay under other circumstances. Impositions which were plainly penalties were set apart and dealt with in other sections, and in the sections prescribing interest, the imposition is explicitly declared to be such. This legislative declaration we do not think may be disregarded merely because different sections prescribe different rates." The court cited in support of its conclusion, among others, our decision in Hughson v. United States, 59 F. 2d. 17, 19, which was noted for comparison.

In In re Beardsley & Wolcott Mfg. Co., 82 F. 2d. 239, the Second Circuit Court of Appeals again considered the provisions of §57 (j) of the Bankruptcy Act (11 U. S. C. A. §93 (j)), supra, which is made applicable to reorganization proceedings under §77B (11 U. S. C. A. §207, §1, 48 Stats. 912), with reference to the allowance of interest under a statute of the state of Connecticut, which provided that: "The delinquent portion of any tax shall be subject to interest at the rate of three-fourths of one per cent for each month or fraction thereof which shall elapse from the time when it shall have become due and payable until the same shall be paid; * * *". §380 c of 1931-1933-1935 Supplement to Connecticut Statutes, pp. 145, 146. The court said: "But we are not concerned with the wisdom of the statute. The rates fixed under the taxation and police powers of the state were doubtless governed by mixed financial and social policies. The policies were matters for the

legislature and if it declared any rate which was within the range fixed as compensation for the use of money by private agreement and denominated it 'interest,' we think there should be every presumption that it was such in fact."

The Circuit Court of Appeals for the Eighth Circuit, in Horn v. Boone County, Nebraska, 44 F. 2d. 920, upon the authority of United States v. Childs, supra, held that a statute of the state of Nebraska fixing an interest charge upon taxes was to be regarded as a charge for interest allowable in bankruptcy and not as a penalty to be disallowed. The Nebraska statute there involved provided that after delinquency such taxes "shall draw thereafter 10% per annum, which interest shall be collected the same as tax so due." The court held that inasmuch as Nebraska permitted private agreement to fix as high a rate as 10% interest between private parties, the statute fixing 10% interest upon taxes could not justly be characterized as a penalty. If this rule be applied in California it would follow that 12% is not a penalty because the laws of California permit an even higher rate than 12% per annum with reference to certain types of loans. (Stat. 1919, Cal., LXXXIII; Sec. 22, Art. XX, Cal. Const.)

In In re Martin, 75 F. 2d. 618, the Circuit Court of Appeals for the Seventh Circuit had under consideration a claim of the Director of Finance of the State of Illinois against a bankrupt's estate to recover from a bankrupt distributor of gasoline money which he had collected from the consumers of gaso-

line purchased from him on account of the tax thereon due from them. The court held that the claim was not one for taxes but for debts due by the bankrupt and was entitled to priority under the provisions of §64B (7) of the Bankruptcy Act (11 U. S. C. A. §104B (7)). The statute of the state of Illinois imposing the tax provided that interest at the rate of one per cent per month should be allowed as penalty for wilful delay in payment to the state of the tax collected. The court held that the matter of interest rates was within the power of the state legislature and said: "We find nothing in the record to indicate anything grossly excessive or inequitable in the interest fixed by the statute and carried in the judgment and we are not at liberty to disturb its allowance." It does not appear from the opinion that the attention of the court was directed to the provisions of §57 (j) of the Bankruptcy Act (11 U. S. C. A. §93 (j)). However, a reference to the briefs in the case shows that the appellant therein called the attention of the court to the provisions of §57 (j) of the Bankruptcy Act, supra, and argued that "under no theory should the penalties assessed by the state have been allowed as a part of the claim in this matter". The appellee claimed that although denominated a "penalty" in the statute it "* * * was imposed * * * to compensate the state on account of delay in payment of the tax", citing in support of that proposition People v. Baldwin, 287 Ill. 87, wherein, under a similar state statute, the State Supreme Court held the charge to be interest and not

a penalty. The Circuit Court of Appeals, citing People v. Baldwin, supra, held that the charge of one per cent per month was interest. It did not expressly consider or rule upon the question of whether or not the interest might be so excessive as to constitute a penalty, as such a contention was not presented to it, but it did hold, in effect, that an interest rate of 12% was within the power of the legislature and, consequently, allowable in bankruptcy notwithstanding the provisions of §57 (j), supra, of the Bankruptcy Act.

The only decision by a Circuit Court of Appeals which is at variance with the cases we have discussed is by the Circuit Court of Appeals for the Third Circuit in Pressed Steel Car Co. of New Jersey, 100 F. 2d. 147, which said, with reference to a claim of one per cent per month upon delinquent taxes: "We think that there is no doubt that the interest rate of 1% per month for each month that the tax remains unpaid proposed to be levied by the statute * * * is a penalty." The court cited New York v. Jersawit, 263 U. S. 493, 496, supra, in support of its conclusion, but did not cite or mention the later decision of the Supreme Court in United States v. Childs, supra, in which New York v. Jersawit is explained and limited, nor did it cite the decisions of other Circuit Courts of Appeals above cited.

In view of the controlling decision by the Supreme Court (Childs v. United States, supra) it is unnecessary to cite or discuss a number of decisions

of the District Courts cited to us in which it has been held that the provision for interest upon delinquent taxes imposed by the taxing statutes was a penalty within the meaning of §57 (j) of the Bankruptcy Act (11 U. S. C. A. §93 (j)), supra.[2]

The appellee cites a ruling of the Attorney General of the state referring to the charge in §45, supra, as an "interest penalty". The letter was addressed to the appellant in reply to a question sub-

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[2]In re Ashland Emery & Corundum Co., 229 F. 829, was overruled by the Supreme Court in Childs v. United States, supra. In re Denver and Rio Grande R. Co., 27 F. 2d 983, the court held 2% per month interest to be a penalty within the meaning of §57 (j) of the Bankruptcy Act, supra, and approved an allowance of 6% only, the statutory rate for interest.

Circuit Judge Evans sitting as District Court Judge in re Adams Building Corp., 27 F. Supp. 247, held that interest penalties and costs on a tax should be reduced to five per cent interest in a reorganization proceeding citing as authority, New York v. Jersawit, 263 U. S. 493, and In re Clark Realty Co., (7 C. C. A.) 253 F. 938; the point was not contested on appeal. In re Adams Bldg. Corp., (C. C. A. 7) 105 F. 2d. 764; cf., In re Martin, (CCA 7) supra; see also, In re A. E. Fountain, 295 Fed. 873, from the U. S. District Court of New York, in effect overruled by later decisions of the Circuit Court of Appeals of the Second Circuit, supra. In re Wells, U. S. District Court of Maryland, 4 F. Supp. 329, no claim was made for interest or penalties on taxes and what is said in reference thereto is obiter. In Powell v. Allen, 70 Cal. App. 663, it is said that interest on delinquent taxes is not interest but a penalty, citing Colby v. Medford, 85 Or. 485. The remark is obiter.

mitted to him as to whether the appellant had power to waive "interest charges" accruing under §45, supra. The attention of the Attorney General was not directed to the provisions of §57 (j) of the Bankruptcy Act, supra.

We regard the letter as without significance in the construction of the Bankruptcy Act of §45, supra.

The decision of the trial court is reversed with instructions to approve the claim for the entire balance of the amount of the interest at 12% fixed by the state statute.

[Endorsed]: Opinion. Filed Dec. 12, 1940. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals
for the Ninth Circuit

No. 9501

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,

Appellant,

vs

HARRY F. MEILINK, as Trustee, etc.,

Appellee.

DECREE

Appeal from the District Court of the United States for the Northern District of California, Southern Division.

This Cause came on to be heard on the Transcript of the Record from the District Court of the United

States for the Northern District of California, Southern Division, and was duly submitted:

On Consideration Whereof, it is now here ordered, adjudged, and decreed by this Court, that the order of the said District Court in this cause be, and hereby is, reversed, with instructions to approve the claim for the entire balance of the amount of the interest at twelve percentum fixed by the state statute, with costs in favor of the appellant and against the appellee.

It is Further Ordered, Adjudged, and Decreed by this Court, that the appellant recover against the appellee for its costs herein expended, and have execution therefor.

[Endorsed]: Filed and entered December 12, 1940. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals
for the Ninth Circuit

Excerpt from Proceedings of Monday, March 10, 1941.

Before: Wilbur, Garrecht and Healy,
Circuit Judges.

[Title of Cause.]

ORDER DENYING PETITION FOR REHEARING

Upon consideration thereof, and by direction of the Court, It Is Ordered that the petition of Harry

F. Meilink, as Trustee in Bankruptcy, etc., filed January 10, 1941, and within time allowed therefor by rule of court, for a rehearing of above cause be, and hereby is denied.

[Title of Circuit Court of Appeals and Cause.]

ORDER STAYING ISSUANCE OF MANDATE

Upon application of Mr. James M. Conners, counsel for the appellee, and good cause therefor appearing, It Is Ordered that the issuance, under Rule 28, of the mandate of this Court in the above cause be, and hereby is stayed to and including April 30, 1941; and in the event the petition for a writ of certiorari to be made by the appellee herein be docketed in the Clerk's office of the Supreme Court of the United States on or before said date, then the mandate of this Court is to be stayed until after the said Supreme Court passes upon the said petition.

CURTIS D. WILBUR
United States Circuit Judge

Dated: San Francisco, California, April 11, 1941.

[Endorsed]: Filed Apr. 11, 1941. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

CERTIFICATE OF CLERK, U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing forty-six (46) pages, numbered from and including 1 to and including 46, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the appellee, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 17th day of April, 1941.

[Seal] PAUL P. O'BRIEN,
Clerk.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 13, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(7481)

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1940

No. [illegible]

HARRY F. MEHLINK, as Trustee in Bankruptcy of the Estate of United Lamp & Shade Corp. (a corporation), Bankrupt,

Petitioner,

vs.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,

Respondent.

PETITION FOR WRIT OF CERTIORARI

to the United States Circuit Court of Appeals

for the Ninth Circuit

and

SUPPORTING BRIEF.

JOHN WALTON DINKELSPIEL,
[illegible]
Counsel for Petitioner.

DINKELSPIEL & DINKELSPIEL,
[illegible]

GRANT H. WREN,

JAMES M. CONNERS,
[illegible]

Of Counsel.

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1940

No.

HARRY F. MEILINK, as Trustee in Bankruptcy of the Estate of United Lamp & Shade Corp. (a corporation), Bankrupt,
Petitioner,

vs.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Charles Evans Hughes, Chief Justice of the Supreme Court of the United States, and to the Associate Justices of the Supreme Court of the United States:

Harry F. Meilink, Trustee in Bankruptcy of the estate of United Lamp & Shade Corp., a corporation,

Bankrupt, the petitioner above named, respectfully prays that a writ of certiorari issue to review a judgment entered December 12, 1940 in the United States Circuit Court of Appeals for the Ninth Circuit in the case numbered 9501, entitled "Unemployment Reserves Commission of the State of California, Appellant, v. Harry F. Meilink, as Trustee in Bankruptcy of the estate of United Lamp & Shade Corp., a corporation. Bankrupt, Appellee", reversing the judgment of the United States District Court for the Northern District of California, Southern Division; and in this behalf petitioner respectfully shows:

OPINION OF THE COURT BELOW.

The opinion of the Circuit Court of Appeals for the Ninth Circuit was rendered on the 12th day of December, 1940 and is set forth in the Transcript of Record at pages 32 to 44, inclusive, and the petition for rehearing filed with the Circuit Court of Appeals for the Ninth Circuit on the 10th day of January, 1941 was denied (Tr. 45) two months later, on the 10th day of March, 1941.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

In the bankruptcy proceeding of United Lamp & Shade Corp., a corporation, a proof of claim (Tr. 6) was filed by the Unemployment Reserves Commission of the State of California for employer and employee contributions, demanding interest thereon at the rate of twelve per cent per annum. Your petitioner as

Trustee in Bankruptcy paid the principal sum of said proof of claim with interest thereon at the rate of six per cent per annum and filed an Objection (Tr. 7) to the twelve per cent per annum interest demanded, upon the ground that the difference between the six per cent per annum interest paid by him and the twelve per cent per annum interest demanded constituted a penalty within the purview of Section 57j of the Bankruptcy Act. (Title 11, U. S. C. A. Sec. 93j.) The Objection of the Trustee to the payment of the penalty came on for hearing before the Referee in Bankruptcy and the Objection of your petitioner to the payment of a penalty was sustained, the Referee in Bankruptcy (Tr. 9) directing the payment of interest at the rate of seven per cent per annum on the proof of claim upon the ground that said percentage was the legal rate of interest in the State of California.

The Unemployment Reserves Commission of the State of California filed a petition to review the order of the Referee in Bankruptcy (Tr. 15), and his Certificate and Report (Tr. 18) and his Order came on for hearing before the United States District Court for the Northern District of California, Southern Division, and an Order (Tr. 24) was duly made and entered by the District Judge approving and confirming the certificate and report and the order of the Referee in Bankruptcy. An appeal (Tr. 28) was taken from the Order of the District Court to the Ninth Circuit Court of Appeals and on the 12th day of December, 1940 its Order (Tr. 31) was duly made

and entered reversing the Order of the District Court for the Northern District of California, with instructions to approve the proof of claim with interest thereon at the rate of twelve per cent per annum.

QUESTION PRESENTED.

Is interest at the rate of 12% per annum, which under the provisions of the Unemployment Reserves Commission of the State of California charged pursuant to Section 45 of the Unemployment Reserves Act of California, and which is 5% in excess of the legal rate of interest of the State of California of 7% per annum and which rate of interest of 12% is included in the proof of claim of the Unemployment Reserves Commission of the State of California, a penalty in bankruptcy rather than interest within the purview of Section 57j of the Bankruptcy Act?

STATUTES INVOLVED.

Section 45 of the Unemployment Reserves Act (Chapt. 352, 1935 Statutes of California, page 1226), during the period the contributions and interest claimed by the respondent accrued read as follows:

> "If any employer defaults in any payment required of him, for himself or on behalf of employees under this act, he shall become *additionally liable* for interest on such payments at the rate of twelve per cent per annum from the date such payment becomes due, both principal

and interest being payable in the same manner as the contributions. Such payment and interest shall be collectible in the name of the fund in any manner practicable, including civil action by the commission against the defaulting employer." (Italics ours.)

Section 57j of the Bankruptcy Act (Title 11 U. S. C. A. Sec. 93j) during the period the contributions and interest claimed by the respondent accrued, read as follows:

"Debts owing to the United States, a state, a county, a district, or a municipality as a *penalty* or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law." (Italics ours.)

— —

REASONS FOR GRANTING WRIT OF CERTIORARI.

I.

THE CIRCUIT COURT OF APPEALS HAS IN THIS MATTER DECIDED A MOST IMPORTANT QUESTION OF LAW IN CONFLICT WITH A CONTROLLING DECISION OF THE SUPREME COURT OF THE UNITED STATES.

The decision rendered by the Ninth Circuit Court of Appeals clearly conflicts with a decision of the United States Supreme Court in *New York v. Jersawit*, 263 U. S. 493, 68 L. Ed. 405, 44 Sup. Ct. 167, 2 A. B. R. (N. S.) 292, and there is found a factual similarity between the pending matter and the facts

disclosed in the above cited case. In *New York v. Jersawit,* supra, this Court had submitted to it for decision a statute of the State of New York providing for the payment of a penalty upon delinquent corporate franchise tax due the state. The Trustee in Bankruptcy interposed objections to a proof of claim filed, upon the ground that a penalty was being exacted for the neglect of the bankrupt corporation in making prompt payment of its tax, and this Court held that the State of New York was only entitled to receive simple interest instead of the twelve per cent per annum demanded.

The Ninth Circuit Court of Appeals in the pending matter has erred in its failure to follow the decision of this Court in *New York v. Jersawit,* supra, and in relying upon the decision of this Court in *United States v. Childs,* 266 U. S. 304, 69 L. Ed. 299, 45 Sup. Ct. 110, 5 A. B. R. (N. S.) 5, which is clearly distinguishable and not in point on both facts and the reasoning of this Court, since it relates to a *Federal* statute rather than a *State* statute as in the instant case.

II.

THE CIRCUIT COURT OF APPEALS HAS IN THIS MATTER RENDERED A DECISION IN CONFLICT WITH A DECISION OF ANOTHER CIRCUIT COURT OF APPEALS IN A SIMILAR MATTER.

The decision of the Ninth Circuit Court of Appeals in the pending matter is clearly in conflict with the decision of the Third Circuit Court of Appeals in the

matter of *Pressed Steel Car Co. of New Jersey,* 100 Fed. (2d) 147, 38 A. B. R. (N. S.) 571, wherein the Third Circuit Court of Appeals sustained the objection of the Trustee in Bankruptcy to a proof of claim of the State of New Jersey demanding interest at twelve per cent per annum and ordered the payment of simple interest. A writ of certiorari to review this decision of the Third Circuit Court of Appeals was denied by this Court (306 U. S. 648, 83 L. Ed. 1047, 59 Sup. Ct. 589) on the 13th day of March, 1939. A factual similarity in the *Pressed Steel Car Co.* case and in the pending matter is clearly shown, in that the State of New Jersey and the State of California both demanded interest at the rate of twelve per cent per annum. The two decisions are in conflict due to the Third Circuit Court of Appeals reducing interest from twelve per cent per annum to simple interest and the Ninth Circuit Court of Appeals reversing the order of the District Court for the Northern District of California directing payment of seven per cent per annum interest and allowing interest at twelve per cent per annum.

CONCLUSION.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and send to this Court for its review and determination, on a

day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket "No. 9501, Unemployment Reserves Commission of the State of California, Appellant, v. Harry F. Meilink, as Trustee in Bankruptcy of the estate of United Lamp & Shade Corp., a corporation, Bankrupt, Appellee", and that said judgment of the United States Circuit Court of Appeals for the Ninth Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Dated, San Francisco, California,
April 25, 1941.

JOHN WALTON DINKELSPIEL,
Counsel for Petitioner.

DINKELSPIEL & DINKELSPIEL,
GRANT H. WREN,
JAMES M. CONNERS,
Of Counsel.

Appendix.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1940

No.

HARRY F. MEILINK, as Trustee in Bankruptcy of the Estate of United Lamp & Shade Corp. (a corporation), Bankrupt,
Petitioner,

vs.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINION OF THE COURT BELOW.

The opinion of the Circuit Court of Appeals for the Ninth Circuit is printed in the record, pages 32 to 44, inclusive, and for brevity is not repeated here.

II.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240, as amended, of the Judicial Code, 28 U. S. C. A. 347.

III.

STATEMENT OF THE CASE.

The essential facts of the case at bar are stated in the accompanying petition for writ of certiorari and in the interest of brevity are not repeated herein.

IV.

SPECIFICATION OF ERROR.

The question involved is set out in the petition proper. To define the position of petitioner more precisely, it is specified that the Circuit Court of Appeals for the Ninth Circuit erred in holding:

That so-called twelve per cent per annum interest be paid by the Trustee in Bankruptcy to the Unemployment Reserves Commission of the State of California on its proof of claim for unpaid contributions and by doing so thereby ordered payment of a penalty of five per cent in excess of the legal rate of seven per cent per annum interest in the State of California, contrary to the provisions of Section 57j of the Bankruptcy Act.

V.

SUMMARY OF ARGUMENT.

We shall present our argument under two main headings, corresponding in order and substance to the reasons for granting the writ of certiorari stated in the petition proper and referring to the question and specification of error hereinabove mentioned.

POINT I.

THE DECISION OF THE NINTH CIRCUIT COURT OF APPEALS CONFLICTS WITH THE CONTROLLING DECISION OF THIS COURT IN THE CASE OF NEW YORK v. JERSAWIT.

Your petitioner respectfully submits that the Ninth Circuit Court of Appeals erred in its failure to follow the decision of this Honorable Court in *New York v. Jersawit,* 263 U. S. 493, 68 L. Ed. 405, 44 Sup. Ct. 167, 2 A. B. R. (N. S.) 292. The facts in this decision of this Court disclose that the Trustee in Bankruptcy interposed objections to the rate of interest and a penalty demanded by the State of New York for delay in the payment of a delinquent corporate franchise tax due the state. In the matter involved in the within petition for a writ of certiorari, the State of California is also seeking to exact under the guise of interest a penalty for failure of the bankrupt corporation to make prompt payment of contributions due the State of California. The twelve per cent per annum interest on the contributions claimed is in excess of the value of the use of money at the normal return on funds during the contribution period

and Section 57j of the Bankruptcy Act prohibits the payment of any sum as a penalty or forfeiture, except for the amount of pecuniary loss sustained by the act out of which the penalty or forfeiture arose. The respondent in this proceeding was paid the full principal sum of the contributions owing it and any interest it is entitled to receive cannot exceed a normal rate of interest payable in ordinary business transactions. This Court in *New York v. Jersawit*, supra, found that twelve per cent per annum interest is more than the value of the use of money and affirmed that portion of the decision of the Second Circuit Court of Appeals ordering the payment of simple interest on the proof of claim of the State of New York. This Court in its opinion, in addition, held that the exaction of ten per cent per annum for failure to make prompt payment of the franchise tax to the state was also a penalty disallowed by Section 57j of the Bankruptcy Act and in affirming that portion of the decision of the Second Circuit Court of Appeals allowing six per cent per annum interest to the State of New York, holding that twelve per cent per annum interest is excessive, said in 68 L. Ed., page 407:

> *"As the 1 per centum is more than the value of the use of the money*, and is added by the statute to the 10 to make a single sum, it must be treated as part of one corpus and must fall with that. *We presume that, in this event, the state does not object to receiving the simple interest allowed. That part of the order will stand."* (Italics ours.)

The Ninth Circuit Court of Appeals in the pending matter predicated its decision reversing the order of the District Court upon *United States v. Childs,* 266 U. S. 304, 69 L. Ed. 299, 45 Sup. Ct. 110, 5 A. B. R. (N. S.) 5, and your petitioner respectfully submits that the distinction clearly shown in the facts of this case and the reasoning of this Court did not justify the Ninth Circuit Court of Appeals in relying upon the same. In *United States v. Childs,* supra, a bankruptcy proof of claim involving accrued *Federal* taxes and not a *State* tax was filed by the Collector of Internal Revenue. Interest at twelve per cent per annum as provided in Act October 3, 1917, 40 Stat. at L. 300, Chap. 63, Paragraph 212, was demanded and the Circuit Court of Appeals for the Second Circuit held that any interest in excess of six per cent per annum was in effect a penalty and was not saved by its name though it was imposed by the Legislature and within the legislative power. This Court properly reversed that decision and ordered payment of interest at the rate of twelve per cent per annum as provided in the *Federal* statute. In doing so, this Court based its reversal order on the ground that uniformity of interpretation of a *Federal* statute was essential in all the States and such uniformity must be had in order that no Federal District or Circuit Court could apply the legal rate of interest of the state in which the bankruptcy proceeding was pending when construing a *Federal* statute involved in a proof of claim to which objection has been interposed to the rate of interest demanded in excess of the legal rate of

the state or substitute a rate of interest depending upon the value of money then prevalent. In 69 L. Ed. 301, this Court said:

> "It makes the rate of interest that of a particular locality, differing with the locality,—in New York, as said by the government, 6 per cent; in the Middle West, 8 per cent; and on the Pacific coast, 10 per cent; *and abridges or controls a Federal statute by a local law or custom, and takes from it uniformity of operation.*" (Italics ours.)

Your petitioner submits that the Circuit Court of Appeals for the Ninth Circuit was not justified in relying upon *United States v. Childs,* supra. The Ninth Circuit Court was construing a statute of the State of California and not a *Federal* statute, so there was no question of uniformity of operation to be considered. There being no factual similarity whatsoever between the pending matter and the facts found in *United States v. Childs,* supra, the Ninth Circuit Court of Appeals should have followed the decision of this Court in *New York v. Jersawit,* supra. A factual similarity is evident between the pending matter and the *Jersawit* case due to proofs of claim having been filed respectively by the State of California and the State of New York. Your petitioner respectfully submits that the decision of this Court in *New York v. Jersawit,* supra, is controlling, that the opinion of the Ninth Circuit Court of Appeals is plainly in conflict with the same and that his petition for a writ of certiorari is justified.

The *New York v. Jersawit* decision has been cited by this Court in its recent decision in *Texas v. Donoghue,* 82 L. Ed. 264, 302 U. S. 284, 58 Sup. Ct. 192, 35 A. B. R. (N. S.) 143, and in its very recent decision in *Boteler v Ingels,* 84 L. Ed. 78, 308 U. S. 57, 60 Sup. Ct. 29, 41 A. B. R. (N. S.) 141. In *Texas v. Donoghue* at page 266, Justice Butler, speaking for the Court, said:

> "The bankruptcy court has jurisdiction under sovereignty that is independent of and foreign to that of the state. Moore v. Mitchell, 281 U. S. 18, 23, 74 L. Ed. 673, 676, 50 S. Ct. 175. *It is without power to enforce penalties imposed by the state for violation of its laws."* (Italics ours.)

Justice Black in the *Boteler v. Ingels* case also referred to the disallowance of tax penalties in bankruptcy proceedings and referred to the provisions of Section 57j of the Bankruptcy Act prohibiting the payment of the same. Your petitioner, in recognizing that the payment of interest of seven per cent per annum to the respondent in this matter is the maximum rate which it is entitled to receive, considered the payment of the additional five per cent demanded as being a penalty designed to compensate the respondent for delay in payment of its contributions. This Court has held that a court of bankruptcy is without power to enforce penalties imposed by the state for violation of its laws in the case of *Texas v. Donoghue,* supra, and for the purpose of determining the right of the respondent to exact a penalty your

petitioner is seeking the issuance of a writ of certiorari.

New York v. Jersawit, supra, has also been cited with approval in the case of *Pressed Steel Car Co. of New Jersey,* 100 Fed. (2d) 147, 38 A. B. R. (N. S.) 571, which will be discussed hereafter under Point II and in several decisions of the District Courts of the United States.

In the case of *In re 168 Adams Building Corporation* (D. C. Ill.), 27 Fed. Supp. 247, 40 A. B. R. (N. S.) 444, interest demanded by a county tax collector of the State of Illinois in a bankruptcy proof of claim in an amount in excess of the legal rate of interest in Illinois was reduced to the legal rate of five per cent. Circuit Judge Evans of the Seventh Circuit Court of Appeals, sitting as a District Judge, said on pages 249-250:

> "As to interest, penalties, costs, etc., which have accrued and which I am informed are large, they should be reduced to five per cent interest upon all unpaid taxes from the date their payment was lawfully and properly demanded.
>
> "This ruling is on the ground that complainant has come into this court for the allowance, protection, and enforcement of its claim. The legal rate of interest in Illinois is five per cent. * * *
>
> "It seems to me that the part of the claim which is for penalties or for excessive interest is vulnerable to objection, even though the tax itself may be immune from such attack. Title 11, U. S. C. A. Sec. 93(j); Ill. Stats. Chap. 120,

Sec. 165; *New York v. Jersawit*, 263 U. S. 493, 44 S. Ct. 167, 68 L. Ed. 405; In re Clark Realty Co., 7 Cir., 253 F. 938. * * *" (Italics ours.)

"The claim will be allowed with simple interest at five per cent from the date when demand for its payment was duly made."

New York v. Jersawit, supra, is also cited with approval in the case of *In re Denver and R. G. W. R. Co.*, (D. C. Colo.) 27 Fed. Supp. 983, 40 A. B. R. (N. S.) 520, wherein the facts disclose that the Treasurer of the State of Colorado was demanding a payment of twenty-four per cent per annum interest on its bankruptcy proof of claim. The District Court held that fixing such an excessive rate of interest was for the purpose of forcing payment of the tax when due and reduced the interest to the legal rate of six per cent per annum provided by the Colorado law. On page 984 the Court said:

"It is important to note that Sec. 57j, in addition to the debt, allows only the pecuniary loss sustained by the state as a result of the failure to pay the tax on time, plus such interest as may have accrued according to law. Legal interest in Colorado is 6%. No showing of any loss sustained by the state is made, other than interest from the date payment was due. Money, especially in these days, is not worth 2% a month and the money would not have drawn 2% a year had it been on deposit in a bank. See also In re 168 Adams Building Corporation, D. C., 27 F. Supp. 247.

"We think the intent of the legislature as manifested by this provision was to force payment of the tax when due.

"The petition is denied."

Your petitioner respectfully submits that the Ninth Circuit Court of Appeals has failed to carefully analyze the terms of Section 45 of the Unemployment Reserves Commission Act providing that the delinquent employer is penalized by becoming additionally liable for so-called interest if he fails to make prompt payment of his contributions. The following pertinent language found in *Remington on Bankruptcy,* Volume 2, pages 234-235 summarizes the position taken by your petitioner regarding the necessity of the Court ascertaining whether or not interest or a penalty is being exacted by taxing authorities:

> *"A penalty as contrasted with a tax has an essentially different aim, its primary purpose being to regulate conduct rather than to produce revenue,* whereas with a tax, the former purpose is only incidental. A tax is rarely imposed for an omission to act, *while a penalty is frequently, if not usually, so based.* Further distinction may be found in the facts that a penalty is more likely to be based upon a single act or failure to act rather than upon a series of acts, and that it also ordinarily has a less direct relation to the receipt of earnings by the one upon whom the burden falls which renders him able to pay it. *The label placed upon an imposition in a revenue measure is not decisive in determining its character. Although called a tax, it may in*

fact constitute a penalty, and if so the courts will not shut their eyes to the fact, but will give it the same legal effect as a *penalty* which is designated as such." (Italics ours.)

POINT II.

THE NINTH CIRCUIT COURT OF APPEALS HAS RENDERED ITS DECISION IN THE PENDING MATTER IN CONFLICT WITH THE PRESSED STEEL CAR CO. OF NEW JERSEY DECISION OF THE THIRD CIRCUIT COURT OF APPEALS.

In addition to seeking the issuance of a writ of certiorari by this Court due to the failure of the Ninth Circuit Court of Appeals to follow the decision of this Court in the case of *New York v. Jersawit,* supra, your petitioner bases his petition for a writ of certiorari upon the conflict between the Ninth Circuit Court of Appeals decision in the pending matter and the decision of the Third Circuit Court of Appeals in the case of *Pressed Steel Car Co. of New Jersey,* 100 Fed. (2d) 147, 38 A. B. R. (N. S.) 571. In this case, in which the decision of this Court in the case of *New York v. Jersawit,* supra, was followed, the State of New Jersey had filed a bankruptcy proof of claim for franchise taxes demanding payment of interest at twelve per cent per annum. The Third Circuit Court of Appeals disallowed the interest demanded and directed payment of simple interest on the proof of claim. Citing *New York v. Jersawit,* supra, the Court said on page 153:

"One question remains. Is the appellant entitled to collect 1% per month upon its claims?

> Section 57j, 11 U.S.C.A. Sec. 93 (j), of the Bankruptcy Act, specifically referred to in Section 77B(k) as being applicable to reorganization proceedings prohibits the allowance of penalties upon claims in bankruptcy proceedings. *We think that there is no doubt that the interest rate of 1% per month for each month that the tax remains unpaid proposed to be levied by the statute* (P. L. N. J. 1919, ch. 118, p. 280, Sec. 1, Comp. St. Supp. N. J. 1924, Sec. 208-505a, as amended by P. L. N. J. 1927, ch. 261, p. 481, Sec. 1 supplementing L. 1884, ch. 159, p. 232, as amended by P. L. N. J. 1931, ch. 102, p. 171) *is a penalty. New York v. Jersawit*, 263 U. S. 493, 496, 44 S. Ct. 167, 68 L. Ed. 405. *In the case at bar we presume that the State of New Jersey will not object to receiving simple interest and if this be so, such interest should be allowed on the claims.*" (Italics ours.)

This Court denied a petition for writ of certiorari (see 83 L. Ed. 1047, 306 U. S. 648, 59 Sup. Ct. 589) on March 13, 1939.

In the matter involved in the pending petition for the issuance of a writ of certiorari, the decision of the Ninth Circuit Court of Appeals is in plain conflict with the Third Circuit Court decision above mentioned. In the pending matter as well as in the *Pressed Steel Car Co.* case the State of California and the State of New Jersey, respectively, were demanding interest at the rate of twelve per cent per annum on bankruptcy proofs of claim. The Ninth Circuit Court of Appeals allowed interest at the rate of twelve per cent per annum demanded and the Third Circuit

Court of Appeals reduced the twelve per cent per annum interest demanded to simple interest. The Trustee in the pending matter respectfully submits that this conflict in the decisions of two Circuit Courts of Appeal justifies the granting of his petition for a writ of certiorari.

Upon the foregoing considerations and for the several reasons herein specified, your petitioner respectfully prays that this Honorable Court take jurisdiction in the premises, issue its writ of certiorari and reverse the decision of the Ninth Circuit Court of Appeals.

Dated, San Francisco, California,
April 25, 1941.

Respectfully submitted,
JOHN WALTON DINKELSPIEL,
Counsel for Petitioner.

DINKELSPIEL & DINKELSPIEL,
GRANT H. WREN,
JAMES M. CONNERS,
Of Counsel.

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In the Supreme Court

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United States

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OCTOBER TERM, 1941

No. 61

HARRY F. MEILINK, as Trustee in Bankruptcy of the Estate of United Lamp & Shade Corp. (a corporation), Bankrupt,

Petitioner,

vs.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,

Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR PETITIONER.

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In the Supreme Court
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OCTOBER TERM, 1941

No. 61

HARRY F. MEILINK, as Trustee in Bankruptcy of the Estate of United Lamp & Shade Corp. (a corporation), Bankrupt,
Petitioner,

vs.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR PETITIONER.

OPINION BELOW.

The opinion of the Ninth Circuit Court of Appeals (R. 32-44) is reported in 116 F. (2d) 330.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered December 12, 1940. (R. 44-45.) The petition for a writ of certiorari was filed April 28, 1941 and was granted October 6, 1941. The jurisdiction of this Court is invoked under Section 240, as amended, of the Judicial Code, 28 U. S. C. A. 347.

QUESTION PRESENTED.

Is so much of the interest at the rate of 12% per annum, exacted by the Unemployment Reserves Commission of the State of California pursuant to Section 45 of the Unemployment Reserves Act of California, which is 5% in excess of the legal rate of interest of the State of California of 7% per annum, and which excess rate is included in the proof of claim of the Unemployment Reserves Commission of the State of California, a penalty in bankruptcy rather than interest within the purview of Section 57j of the Bankruptcy Act?

STATUTES INVOLVED.

Section 45 of the Unemployment Reserves Act (Chapt. 352, 1935 Statutes of California, p. 1226), during the period the contributions and interest claimed by the respondent accrued, read as follows:

> "If any employer defaults in any payment required of him, for himself or on behalf of employees under this act, he shall become *addition-*

> *ally liable* for interest on such payments at the rate of twelve per cent per annum from the date such payment becomes due, both principal and interest being payable in the same manner as the contributions. Such payment and interest shall be collectible in the name of the fund in any manner practicable, including civil action by the commission against the defaulting employer." (Italics ours.)

Section 57j of the Bankruptcy Act (Title 11 U. S. C. A. Sec. 93j) during the period the contributions and interest claimed by the respondent accrued, read as follows:

> "Debts owing to the United States, a state, a county, a district, or a municipality as a *penalty* or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law." (Italics ours.)

Section 64a (4) of the Bankruptcy Act (Title 11 U.S.C.A. Sec. 104) reads as follows:

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be
>
> * * * * * * *
>
> "(4) Taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order

shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court."

The Constitution of the State of California, Article XX, Section 22, during the period the contributions and interest claimed by respondent accrued, read as follows:

"The rate of interest upon the loan or forbearance of any money, goods or things in action, or on accounts after demand or judgment rendered in any court of the State, shall be seven per cent per annum but it shall be competent for the parties to any loan or forbearance of any money, goods or things in action to contract in writing for a rate of interest not exceeding ten per cent per annum. * * *"

STATEMENT.

In the bankruptcy proceeding of United Lamp & Shade Corp., a corporation, a proof of claim (R. 6) was filed by the Unemployment Reserves Commission of the State of California for employer and employee contributions, demanding interest thereon at the rate of 12% per annum. The Trustee in Bankruptcy paid the principal sum of said proof of claim with interest thereon at the rate of 6% per annum and filed an objection (R. 7) to the 12% per annum interest de-

manded, upon the ground that the difference between the 6% per annum interest paid by him and the 12% per annum interest demanded constituted a penalty within the purview of Section 57j of the Bankruptcy Act. (Title 11, U. S. C. A. Sec. 93j.) The objection of the Trustee to the payment of the penalty came on for hearing before the Referee in Bankruptcy and the objection to the payment of a penalty was sustained, the Referee in Bankruptcy (R. 9) directing the payment of interest at the rate of 7% per annum on the proof of claim upon the ground that said percentage was the legal rate of interest in the State of California.

The Unemployment Reserves Commission of the State of California filed a petition to review the order of the Referee in Bankruptcy (R. 15), and his certificate and report (R. 18) and his order came on for hearing before the United States District Court for the Northern District of California, Southern Division, and an order (R. 24) was duly made and entered by the District Judge approving and confirming the certificate and report and the order of the Referee in Bankruptcy. An appeal (R. 28) was taken from the order of the District Court to the Ninth Circuit Court of Appeals and on the 12th day of December, 1940 its order (R. 31) was duly made and entered reversing the order of the District Court for the Northern District of California, with instructions to approve the proof of claim with interest thereon at the rate of 12% per annum.

SPECIFICATION OF ERROR TO BE URGED.

The Circuit Court of Appeals erred:

In ordering so-called 12% per annum interest paid by the Trustee in Bankruptcy to the Unemployment Reserves Commission of the State of California on its proof of claim for unpaid contributions and by doing so thereby directed payment of a penalty of 5% in excess of the legal rate of 7% per annum interest in the State of California, contrary to the provisions of Section 57j of the Bankruptcy Act.

SUMMARY OF ARGUMENT.

Section 45 (R. 2-3 and R. 33) of the California Unemployment Reserves Act providing that an employer who defaults in any payment required of him under the Act shall become additionally liable for interest on such payment at the rate of 12% per annum from the date such payment becomes due, imposes a penalty on a defaulting employer to the extent that the "interest", so-called, exceeds the pecuniary loss resulting from the failure of the employer to pay his contributions when due.

To the extent which such "interest" charge exceeds the pecuniary loss, it is a penalty which, under the provisions of Section 57-j of the Bankruptcy Act, is not provable in a bankruptcy proceeding. The nature of the charge cannot be changed by designating it as interest rather than a penalty. The respondent produced no proof as to its actual pecuniary loss. The general rate of interest in California is 7% per an-

num, unless a rate not to exceed 10% is established by agreement between the parties. There being no proof that the respondent suffered any extraordinary loss as the result of the failure of the bankrupt to promptly pay its assessment, the Circuit Court erred in holding that interest at 12% per annum was not unreasonable.

The Courts have consistently held that interest on delinquent tax payments due to a state, or any subdivision thereof, will not be allowed in a bankruptcy proceeding in excess of the general rate of interest permitted by the applicable state law which, in this case, was 7% per annum. This Court so held in *New York v. Jersawit*, 263 U. S. 493, and said decision is in accordance with the majority of the opinions of the Circuit Courts of Appeals and the District Courts.

The decision of this Court in *U. S. v. Childs*, 266 U. S. 304, is clearly distinguishable in that the statute there interpreted was a federal statute, and the decision therein was based largely upon the necessity for uniformity of interpretation of a federal statute throughout the United States. No reported decision, other than that of the Ninth Circuit Court of Appeals in this proceeding, has applied the reasoning of the *Childs* decision to a state statute.

Federal and other taxing authorities within the State of California exact only 6% per annum interest on claims in bankruptcy, and the Attorney General of California has himself characterized the interest provisions of Section 45 of the California Unemployment Reserves Act as a penalty.

ARGUMENT.

I.

ALLOWANCE OF INTEREST IN EXCESS OF 7% PER ANNUM WOULD PERMIT RESPONDENT TO SHARE IN THE BANKRUPT'S ESTATE TO AN EXTENT NOT REPRESENTED BY A PECUNIARY LOSS.

The ultimate aim of the bankruptcy law is equality between creditors, and to obtain it this Court has held that regard must be had to "the essential nature of transactions and not to their form or accidents". *Clarke v. Rogers*, 228 U. S. 534, 548.

To ensure distribution to creditors on the basis of their actual pecuniary losses resulting from the insolvency of the debtor, the Bankruptcy Act provides, in Section 57-j:

> "Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

The effect of this section was stated by the Circuit Court of Appeals for the Second Circuit in *In re Abramson*, 210 Fed. 878, at page 880, as follows:

> "The law maker who has suffered no pecuniary loss is not permitted to share in the assets of the estate with the creditors who have."

In *In re Caponigri*, 193 Fed. 291 (D.C.N.Y.), Judge Learned Hand said, at page 293:

> "The result would be unjust, because the words of the statute so plainly show the purpose of Congress not to exercise its sovereign right to a preference, except as the United States treasury has suffered. Nothing could be plainer. It would be unjust to thwart so plain a purpose through at best only verbal ambiguity."

Respondent produced no proof whatsoever that interest at the rate of 12% upon its claim is the measure of its actual pecuniary loss, but it relies upon the provisions of Section 45 of the California Unemployment Reserves Act which designates its claim as "interest", and contends that, merely because it is so designated, it must be deemed interest and allowed as such.

Interest on debts is defined in Bouvier's Law Dictionary as follows:

> "The compensation which is paid by the borrower of money to the lender for its use, and, generally, by a debtor to his creditor for recompense for his detention of the debt."

In so far as the interest provided for in Section 45 of the Unemployment Reserves Act exceeds the rate which will fairly compensate it for the loss sustained, it should be held to be a penalty.

In *In re Caponigri* (supra), Judge Learned Hand defined a penalty as follows (p. 292):

> "In substance, an obligation is penal when its amount is measured neither by the obligee's loss nor by the valuation placed by him upon what he is given in exchange."

In *In re Ashland, Emery & Corundum Co.*, 229 Fed. 829, the Court defined a penalty as follows (p. 831):

> "A penalty, as applied to cases of this character, means a punishment imposed for failure to make the payment on time."

The question to be determined, then, is: Is 12% per annum fairly required to make good the loss to the respondent for mere delay in payment of the tax?

While the legislature of California has wide powers in fixing interest rates on delinquent tax payments, merely calling the charge "interest" will not, and cannot, change its character if it be in fact a penalty.

In *U. S. v. LaFranca*, 282 U. S. 568, this Court said (p. 572):

> "no mere exercise of the art of lexicography can alter the essential nature of an act or a thing; and if an exaction be clearly a penalty it cannot be converted into a tax by the simple expedient of calling it such."

Under the provisions of Section 64-a(4) of the Bankruptcy Act, any question arising as to the amount or legality of any taxes is to be heard and determined by the court of bankruptcy. It is the duty of the bankruptcy court to determine whether a claim for so-called interest on delinquent taxes, whether imposed by the federal government, or by any state or subdivision thereof, represents fair compensation for the loss of the use of money, or whether it is in fact a penalty imposed as a punishment for failure to pay.

In *In re J. Menist & Co.*, 290 Fed. 947 (C.C.A. 2nd Cir., reversed on other grounds, 266 U. S. 304), the Court said per Hough, J. (p. 949):

> "Since in bankruptcy (and we are solely concerned with bankruptcy) the power of ascertaining the amount or legality of any tax is vested in the court (section 64 a), and penalties are not to be allowed, except for the amount of pecuniary loss sustained by the delayed payment, the only question here is whether an exaction of 1% a month as the price of delay amounts to a penalty. * * * On the point at bar we are in accord with *In re Ashland, etc. Co.* (D.C.) 229 Fed. 829, which held, that there being no evidence of any injury or damage to the government by the withholding of this tax, except that which flows from the nonpayment of a just debt, anything in excess of the legal rate of interest is to be treated as a penalty and not allowed."

In *In re Denver & R. G. W. R. Co.*, 27 F. Supp. 983 (D.C.Colo.), the Court, refusing to allow interest on delinquent taxes at the rate of 2% a month, said (p. 94):

> "It is important to note that Section 57-j in addition to the debt, allows only the pecuniary loss sustained by the state as a result of the failure to pay the tax on time, plus such interest as may have accrued according to law. Legal interest in Colorado is 6%. No showing of any loss sustained by the state is made, other than interest from the date payment was due. Money, especially in these days, is not worth 2% a month and the money would not have drawn 2% a year had it been on deposit in a bank."

In *In re Ashland Emery & Corundum Co.*, 229 Fed. 829 (D.C. Mass.), the Court, refusing to allow 1% a month on delinquent tax claims, said (p. 832):

> "1 percent a month exceeds what is fairly required to make good loss to the state for mere delay in payment of the tax, and as to such excess is not interest, but constitutes a penalty imposed for failure to pay promptly. * * * What the state lost was the use of money. Its damages therefor are the commonest form known to law and the most certain of estimation. They are established by statute in New Jersey for individuals at 6 percent per annum. * * * It is difficult to see how, as damages, they can be larger in the case of the state."

Throughout these decisions the fundamental thought is that under Section 57-j it would be inequitable for the Court, in the exercise of the duty imposed upon it by Section 64-a, to permit the state to share in a bankrupt's estate to an extent which does not represent an actual pecuniary loss; and when the only loss suffered by the state is occasioned by mere delay in the payment of the tax, interest will not be permitted in excess of the general rate permitted by law, unless a greater pecuniary loss is shown.

This Court will not shut its eyes to the fact that draftsmen of tax statutes often refrain from using the word "penalty" in connection with the sanction imposed for the non-payment of a tax, well knowing that otherwise, in case of bankruptcy, the claim will be exposed to disallowance.

The importance of careful scrutiny of such sanctions lies in the fact that, were the phraseology used by the taxing authority controlling, the measure of its participation in a bankrupt estate would be limited only by what it saw fit to exact. Taxes being entitled to priority under Section 64a of the Bankruptcy Act, general creditors might well be mulcted of the entire estate by the establishment of arbitrary interest rates on delinquent tax claims.

If a statute should provide for interest on delinquent taxes at the rate of 48% per annum, it would be obvious that such a rate would represent a penalty rather than mere reimbursement for pecuniary loss. The dividing line between true interest and a penalty is susceptible of demarcation only if the rule of pecuniary loss be strictly applied. The application of such a rule would seem to require that any rate in excess of the general rate established by the state, or other governmental body, as compensation for loss of the use of money, should be controlling in the absence of affirmative proof on the part of the taxing authority that the loss sustained was greater than that rate.

In California, the general rate of interest is 7%, except that a rate not to exceed 10% may be established by agreement between the parties. Small loan companies, and other similar businesses, are allowed a greater rate of interest, but it may be presumed that such greater rate was established by the legislature upon a showing that the necessities of that type of business require a higher rate in view of the risks assumed and the expense of servicing small loans.

The reasons justifying a higher rate on such loans, however, are not applicable to claims for taxes, especially in view of the priority afforded to tax claims by the provisions of Section 64a of the Bankruptcy Act.

We submit, therefore, that there being no proof in this case that the Unemployment Reserves Commission of California suffered any extraordinary loss as a result of the failure of the bankrupt to promptly pay its assessment, the Circuit Court erred in holding that interest at 12% was not *per se* unreasonable. The burden of proving a loss greater than that represented by the general rate established by the Constitution of California, to wit, 7%, should have been imposed upon the respondent.

II.

THE COURTS HAVE CONSISTENTLY HELD THAT INTEREST ON DELINQUENT TAX PAYMENTS DUE TO A STATE OR ANY SUBDIVISION THEREOF WILL NOT BE ALLOWED IN A BANKRUPTCY PROCEEDING IN EXCESS OF THE GENERAL RATE OF INTEREST PERMITTED BY THE APPLICABLE STATE LAW.

In *New York v. Jersawit*, 263 U. S. 493, the facts disclose that the State of New York was demanding payment in a bankruptcy proceeding of a 10% penalty as well as 12% per annum interest. This Court disallowed the 10% penalty, and finding that 1% a month was more than the value of the use of money, affirmed the decision of the Second Circuit Court of Appeals allowing only 6% per annum interest on the

state's claim. Although this Court considered the penalty and interest as part of one corpus because of the phraseology of the statute, it nevertheless held that 12% per annum interest was excessive and not allowable in a bankruptcy proceeding. Your petitioner respectfully submits that owing to the factual similarity between the *Jersawit* case and the pending matter, the order of the District Court in this proceeding should have been affirmed.

In *In re Pressed Steel Car Co. of New Jersey*, 100 F. (2d) 147, the Third Circuit Court, on the authority of the *Jersawit* case, found that 1% per month interest prescribed by a statute of the State of New Jersey was a penalty and could not be allowed in a bankruptcy proceeding. Allowing only simple interest, the Court said, at page 153:

> *"We think that there is no doubt that the interest rate of 1% per month for each month that the tax remains unpaid proposed to be levied by the statute* * * * is a *penalty* (New York v. Jersawit, 263 U. S. 493, 496, 44 S. Ct. 167, 68 L. Ed. 405). *In the case at bar we presume that the State of New Jersey will not object to receiving simple interest and if this be so, such interest should be allowed on the claims.* (Italics ours.)

In *In re Denver & R. G. W. R. Co.* (D. C. Colo.), 27 F. Supp. 983, wherein interest was claimed at 2% per month and was allowed at 6% per annum, a pertinent discussion by the Court of penalty phraseology used in the statutes and the necessity of any loss sustained by the State being shown, is found at page 984:

"Unfortunately the terms penalties, forfeitures, interest are too often used interchangeably to permit decision solely on the choice of terms made by the draftsman of the Act. 25 C. J. 1178, describes a penalty as a sum of money which the law exacts by way of punishment for doing something that is prohibited or omitting something that is required to be done. That it involves the idea of punishment, either corporal or pecuniary. Elsewhere the same authority, 61 C. J. 1616, sec. 2220, states interest charged on a delinquent tax by statute is not regarded as interest in the sense that it is a consideration for the forbearance of money, but is deemed to be a penalty, and is not a part of the tax, but pertains to the remedy employed to compel payment. * * *

"It is important to note that sec. 57-j, in addition to the debt, allows only the pecuniary loss sustained by the state as a result of the failure to pay the tax on time, plus such interest as may have accrued according to law. Legal interest in Colorado is 6%. No showing of any loss sustained by the state is made, other than interest from the date payment was due. Money, especially in these days, is not worth 2% a month and the money would not have drawn 2% a year had it been on deposit in a Bank. See also In re 168 Adams Building Corporation, D. C., 27 F. Supp. 247. We think the intent of the legislature as manifested by this provision was to force payment of the tax when due.

"The petition is denied."

A similar discussion is also found in *In re Ashland Emery and Corundum Co.* (D. C. Mass.) 229 F. 829,

where the Court, holding that only 6% was allowable on a bankruptcy proof of claim of the State, said at page 832:

> "Assuming, however, that it is, it seems to me plain, and I accordingly find, that 1 per cent a month exceeds what is fairly required to make good loss to the state from mere delay in payment of the tax, and as to such excess is not interest, but constitutes a penalty imposed for failure to pay promptly. The actual damages sustained by the state of New Jersey from the delay are not obscure nor difficult to estimate. What the state lost was the use of the money. Its damages therefor are the commonest form known to the law, and the most certain of estimation. They are established by statute in New Jersey for individuals at 6 per cent per annum. Gen. Stats. of N. J. p. 3704. It is difficult to see how, as damages, they can be larger in the case of the state. * * *
>
> "The sum here claimed is double the statutory interest and almost double the highest rate of interest which national banks are allowed to charge under United States statutes. * * *
>
> "The order of the referee disallowing the claim is reversed; the claim is allowed for interest at 6 per cent on the face of the tax from July 1, 1914, when the tax became due, to April 1, 1915, when it was paid, the amount thereof being $59.22; the balance of the claim is disallowed."

In *In re 168 Adams Building Corporation* (D. C. Ill.), 27 F. Supp. 247 (aff'd. 105 F. (2d) 704 (C. C. A. 7th); cert. denied 308 U. S. 623), interest on a bank-

ruptcy tax claim fixed by a County Tax Collector of Illinois was only allowed at 5%, and at page 249 Circuit Judge Evans of the Seventh Circuit Court of Appeals, sitting as District Judge, said:

> "As to interest, penalties, costs, etc., which have accrued and which I am informed are large, they should be reduced to five per cent interest upon all unpaid taxes from the date their payment was lawfully and properly demanded.
>
> "This ruling is on the ground that complainant has come into this court for the allowance, protection, and enforcement of its claim. The legal rate of interest in Illinois is five per cent."

So also in *In re A. E. Fountain, Inc.* (D. C. N. Y.), 295 . . 873, and in *In re Wells* (D. C. Md.), 4 F. Supp. 329, simple interest only was allowed on tax claims in bankruptcy proceedings.

Neither in *Beardsley & Wolcott Mfg. Co.* (2 C. C. A.), 82 F. (2d) 239 (R. 39), nor in *Horn v. Boone Co.* (8 C. C. A.), 44 F. (2d) 920, cited by the Court below, was interest allowed at a rate in excess of that allowed by agreement under the State statute. In the former case, the Court allowed interest at 9% per annum which was below the statutory limit of 12% allowed by the Connecticut statute. In the latter case, the interest exacted was found to be no greater than interest allowed by agreement under a Nebraska statute providing for two legal rates of interest, to wit, 7% on ordinary debts and not to exceed 10% by agreement of the parties.

In the pending matter, the allowance of 12% per annum interest is *two* per cent in excess of the rate allowed by the provisions of Section 22, Article XX, of the California Constitution, providing for interest at 7% per annum and by agreement of the parties not to exceed *10%* per annum, excepting from these restrictions, however, certain specified lending agencies hereinabove referred to.

The Circuit Court, in its opinion in the instant case, cited the *Martin* case (7 C. C. A.), 75 F. (2d) 618 (R. 40), but in that decision, as the opinion of the Circuit Court herein clearly shows, the penalty provisions of Section 57-j of the Bankruptcy Act were not involved, and the Court there did not consider or rule upon the question of whether the interest might be so excessive as to constitute a penalty. It appears that this contention was not presented for the determination of the Seventh Circuit Court of Appeals in the *Martin* case.

U. S. v. Childs, 266 U. S. 304, is clearly distinguishable in that the statute there involved was a *federal* statute, and the reasoning which led the Court to hold as it did is not applicable in a case arising under a state statute. It is interesting to note that of all the cases decided since the *Childs* case, the Court below, in the instant case, was the first to apply the reasoning of the *Childs* case to a state statute.

In the *Childs* case, the question was the construction of a 1916 Federal Income Tax Statute providing for the payment of a penalty as well as 12% per annum interest. This Court held that the statute was

precise and the penalty and interest provisions were clearly distinguished one from the other. It was unable to find that the word "interest" was used for a cloak for a penalty, but stated in its opinion that the use of the word "interest" would not save it from condemnation if it were, in fact, a penalty. The *Childs* case is distinguishable from the instant case in that the statute was a federal enactment and uniformity of operation in all of the states was a necessary concomitant. Otherwise a different rate of interest would apply in every state or locality depending upon the value of money then prevalent within the jurisdiction where the question arose. At page 301 this Court said:

> "It makes the rate of interest that of a particular locality, differing with the locality, * * *; *and abridges or controls a Federal statute by a local law or custom, and takes from it uniformity of operation.*" (Italics ours.)

The reasons advanced by this Court in the *Childs* case in support of the allowance of interest at 12% per annum have no application to the 12% per annum so-called "interest" involved in the pending matter. Uniformity of interpretation is not here a problem inasmuch as a state and not a federal statute is involved.

Due to the factual difference found in the *Childs* case, your petitioner respectfully submits that the Circuit Court erred in basing its decision in the pending matter thereon and should have affirmed the order of the District Court (R. 24) by following the decision of this Court in *New York v. Jersawit*, 263 U. S. 493.

III.

FEDERAL AND OTHER CALIFORNIA STATE TAXING AUTHORITIES DEMAND ONLY SIX PER CENT PER ANNUM INTEREST ON BANKRUPTCY PROOFS OF CLAIM.

That respondent's claim to 12% exceeds what is fairly required to compensate for the loss of the use of money, is indicated by the interest claimed by other taxing agencies in California in bankruptcy proceedings. The Board of Equalization and the Franchise Tax Commissioner of the State of California only demand 6% per annum interest from trustees in bankruptcy, and the Collector of Internal Revenue makes a like interest demand for Social Security contributions,—which is less than the legal rate allowed by the California Constitution.

Your petitioner respectfully submits that the rate of interest demanded by other taxing agencies in bankruptcy proceedings is a fair amount to be charged for the forbearance of money and that respondent should not be entitled to a prior share in the bankruptcy proceeding in any sum in excess of the California rate of 7% per annum.

IV.

THE ATTORNEY GENERAL OF CALIFORNIA HAS HIMSELF CHARACTERIZED SECTION 45 OF CALIFORNIA UNEMPLOYMENT RESERVES ACT AS A PENALTY SECTION.

Your petitioner directed the attention of the Circuit Court to an opinion of the Attorney General of the State of California prepared for the executive officer of respondent. The Circuit Court (R. 44) commented

upon this opinion by stating that the attention of the Attorney General was not called to the provisions of Section 57-j of the Bankruptcy Act and hence the Circuit Court regarded the opinion as without significance. This opinion reads as follows:

"Earl Warren
Attorney General
State of California
Legal Department

San Francisco, April 27, 1939

Department of Employment
Carl L. Hyde, Executive Officer
1025 P Street
Sacramento, California

Attention: Mr. Maurice P. McCaffrey
Rules and Regulations Officer

Gentlemen:

"I have before me your communication of April 14, 1939, in which you submit the following questions for advice:

'Has the Unemployment Reserves Commission or the Department of Employment the authority under any circumstance to waive interest charges which have accrued under the provisions of the Unemployment Reserves Act and rules and regulations thereunder with respect to delinquent payments of contributions?'

"Section 45 of the Unemployment Reserves Act provides that if any employer fails to make payments required of him in accordance with the provisions of the Act and of the rules and regulations adopted by the Commission it shall become *additionally* liable for interest on such payments at the rate of 12% per annum from the date such payment becomes due. There is no statutory pro-

vision granting discretion to the Commission to waive the *interest penalty* provided for by the Act. *The Commission should make every effort to collect the interest penalty imposed* as well as the contributions due.

Very truly yours,
Earl Warren,
Attorney General,
By John J. Dailey,
Deputy.

Copy of Opinion No. NS1656

JJD/s
2824 RWH"

(Italics ours.)

Your petitioner calls the particular attention of the Court to the italicized language in the opinion wherein the Attorney General described 12% per annum as an *interest penalty* which the respondent cannot waive, and directs it to make every effort to collect the interest *penalty* imposed under Section 45 of respondent's Act.

The Referee in Bankruptcy in his certificate (R. 22-23) commented upon the careful discrimination in the use of the words found in the opinion of the Attorney General. The respondent has had the section of the Act upon which it relies in its attempt to cause your petitioner in this proceeding to pay a penalty for delinquent contributions construed by the Attorney General and his opinion is entitled to great respect and consideration. While not of controlling authority, it might be considered as having quasi-judicial effect and force. Your petitioner supports this contention

by citing *People v. Shearer*, 30 Cal. 645, and *Hutchins v. Merced Co.*, 140 Cal. App. 348, and the following excerpt from Volume 3 California Jurisprudence, page 569, reading:

> "It may be noted that the opinions of the Attorney General are not of controlling authority, yet in view of his relation to the general government, and the nature of his duties, they are regarded as having a quasi-judicial character, and entitled to great respect."

Your petitioner submits that the opinion of the Attorney General clearly supports the decision of the Referee in Bankruptcy which was affirmed by the District Court. Section 45 of the Unemployment Reserves Act causes the delinquent employer to become *additionally* liable for payment of 12% per annum interest and the Attorney General clearly states that the respondent has no discretion to waive the collection of this interest *penalty* and must make every effort to collect the same. Although designated as interest, it is simply a penalty which cannot be allowed under Section 57-j of the Bankruptcy Act.

CONCLUSION.

The label placed upon an imposition in a statute is not decisive in determining its character. Although called interest, it may in fact constitute a penalty, and, if so, the Court should not shut its eyes to the fact but should give it the same legal effect as a penalty described as such.

Your petitioner respectfully submits that the Circuit Court of Appeals erred in relying upon the decision of this Court in the *Childs* case. The factual difference in the pending matter and in the *Childs* case is evident, due to the fact that this Court, in its decision in the *Childs* case, found that the *Federal Statute* being construed was precise and that there was necessity for uniformity of construction of a Federal Statute in all of the states. The Circuit Court erred in failing to follow the decision of this Court in the *Jersawit* case wherein a factual similarity is found. In that case this Court had occasion to construe a *State Statute* and a State *Statute* is also submitted for construction in the pending matter. Under these circumstances, the *Jersawit* case is clearly in point.

Upon the foregoing considerations and authorities, the decision of the Circuit Court should be reversed.

Dated, San Francisco, California,
November 17, 1941.

Respectfully submitted,
W. RANDOLPH MONTGOMERY,
JOHN WALTON DINKELSPIEL,
Counsel for Petitioner.

DINKELSPIEL & DINKELSPIEL,
GRANT H. WREN,
JAMES M. CONNERS,
Of Counsel.

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In the Supreme Court

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United States

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FILED
DEC 8
CHARLES ELMORE CROPLEY

OCTOBER TERM, 1941

No. 61

HARRY F. MEILINK, as Trustee in Bankruptcy, of the Estate of United Lamp & Shade Corp. (a corporation), Bankrupt,

Petitioner,

vs.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,

Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR RESPONDENT.

EARL WARREN,
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MAURICE F. McCAFFREY,
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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1941

No. 61

HARRY F. MEILINK, as Trustee in Bankruptcy, of the Estate of United Lamp & Shade Corp. (a corporation), Bankrupt,
Petitioner,

vs.

UNEMPLOYMENT RESERVES COMMISSION OF THE STATE OF CALIFORNIA,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR RESPONDENT.

OPINION BELOW.

The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 116 Fed. (2d) 330.

JURISDICTION.

As stated by petitioner, the jurisdiction of this Court is invoked under Section 240, as amended, of the Judicial Code, 28 U. S. C. A. 347.

QUESTION PRESENTED.

Is interest at the rate of 12 per cent per annum imposed on delinquent unemployment taxes pursuant to Section 45 of the Unemployment Reserves Act of California, and included in respondent's proof of claim, a penalty in bankruptcy within the purview of Section 57j of the Bankruptcy Act, where such rate is within the legislative power to fix and is expressly denominated as interest by the statute?

STATUTES INVOLVED.

Section 45 of the Unemployment Reserves Act (Chap. 352, Statutes of California 1935) as originally enacted reads as follows:

> "If any employer defaults in any payment required of him, for himself or on behalf of employees under this act, he shall become additionally liable for interest on such payments at the rate of twelve per cent per annum from the date such payment becomes due, both principal and interest being payable in the same manner as the contributions. Such payment and interest shall be collectible in the name of the fund in any manner practicable, including civil action by the commission against the defaulting employer."

Effective August 27, 1937, said Section 45 was amended (Chap. 752, Statutes of California 1937) to read as follows:

> "If any employer fails to make any payment required of him, or fails to deduct and pay to the commission the contributions of his workers, in accordance with the provisions of this act and of the rules and regulations adopted by the commission, he shall become additionally liable for interest on such payments at the rate of twelve per cent per annum from the date such payment becomes due, both principal and interest being payable in the same manner as the contributions. Such payment and interest shall be collectible in the name of the commission in any manner practicable, including civil action by the commission against the defaulting employer."

Effective September 19, 1939, Section 45 was again amended (Chap. 630, Statutes of California, 1939), to change the rate of interest from 12 per cent per annum to one per cent per month or fraction thereof.

Effective September 19, 1939, Section 45.3 was added (Chap. 630, Statutes of California, 1939), to the Unemployment Reserves Act to read as follows:

> "Any employer without good cause failing to pay any contribution within the time required by this act, or the rules and regulations of the commission, shall pay in addition thereto *a penalty of 10 per cent* of the amount thereof together with interest on said contributions at the rate prescribed in this article. If the failure to pay on the part of the employer is due to intentional fraud, *an additional penalty of 15 per cent* may be assessed against, and collected from, such de-

faulting employer. In any proceeding in court brought to enforce the provisions of this section, the finding of the commission that there exists no good cause excusing the delinquency, or that the failure of the employer is due to intentional fraud shall be for all purposes prima facie evidence of the existence of such facts." (Italics supplied.)

For the period during which interest accrued on unemployment taxes, as claimed by the respondent, Section 57j of the Bankruptcy Act (Title 11, U. S. C. A. Sec. 93j) provides:

"Debts owing to the United States, a State, a county, a district, or a municipality as a penalty for forfeiture shall not be allowed except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

Section 64a (4) of the Bankruptcy Act (Title 11, U. S. C. A. Sec. 104) reads as follows:

"The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be

* * * * * * *

"(4) Taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof * * *."

The Constitution of the State of California, Article XX, Section 22, since its adoption in 1934, reads as follows:

"The rate of interest upon the loan or forbearance of any money, goods or things in action, or on accounts after demand or judgment rendered in any court of the State, shall be seven per cent per annum but it shall be competent for the parties to any loan or forbearance of any money, goods or things in action to contract in writing for a rate of interest not exceeding ten per cent per annum.

"No person, association, copartnership or corporation shall by charging any fee, bonus, commission, discount or other compensation receive from a borrower more than ten per cent per annum upon any loan or forbearance of any money, goods or things in action.

"However, none of the above restrictions shall apply to any building and loan association as defined in and which is operated under that certain act known as the 'Building and Loan Association Act,' approved May 5, 1931, as amended, or to any corporation incorporated in the manner prescribed in and operating under that certain act entitled 'An Act defining industrial loan companies, providing for their incorporation, powers and supervision,' approved May 18, 1917, as amended, or any corporation incorporated in the manner prescribed in and operating under that certain act entitled 'An act defining credit unions, providing for their incorporation, powers, management and supervision,' approved March 31, 1927, as amended, or any duly licensed pawnbroker or personal property broker, or any bank as defined in and operating under that certain act known as the 'Bank Act,' approved March 1, 1909, as amended, or any bank created and operating under and pursuant to any laws of this State or

of the United States of America or any nonprofit cooperative association organized under Chapter 4 of Division VI of the Agricultural Code in loaning or advancing money in connection with any activity mentioned in said title or any corporation, association, syndicate, joint stock company, or partnership engaged exclusively in the business of marketing agricultural, horticultural, viticultural, dairy, live stock, poultry and bee products on a cooperative nonprofit basis in loaning or advancing money to the members thereof or in connection with any such business or any corporation securing money or credit from any Federal intermediate credit bank, organized and existing pursuant to the provision of an act of Congress entitled 'Agricultural Credits Act of 1923,' as amended in loaning or advancing credit so secured, nor shall any such charge or any said exempted classes of persons be considered in any action or for any purpose as increasing or affecting or as connected with the rate of interest hereinbefore fixed. The Legislature may from time to time prescribe the maximum rate per annum of, or provide for the supervision, or the filing of a schedule of, or in any manner fix, regulate or limit, the fees, bonus, commissions, discounts or other compensation which all or any of the said exempted classes of persons may charge or receive from a borrower in connection with any loan or forbearance of any money, goods or things in action.

"The provisions of this section shall supersede all provisions of this Constitution and laws enacted thereunder in conflict therewith."

STATEMENT.

Respondent accepts the statement of the case set forth by petitioner on pages 4 and 5 of his brief. For the sake of uniformity, the terms Unemployment Reserves Act and Unemployment Reserves Commission will be used in this brief, although by amendments effective September 19, 1939, the title of the statute was changed to Unemployment Insurance Act and the name of the Respondent-Commission was changed to California Employment Commission.

SUMMARY OF ARGUMENT.

Interest at the rate of 12 per cent per annum, or one per cent per month, on delinquent taxes does not constitute a penalty in bankruptcy where there is no statutory ambiguity to resolve and the legislature fixed the rate of interest to be imposed because of the delay in the payment of the tax after delinquency.

Interest at the rate of 12 per cent per annum is neither excessive nor arbitrary; nor is it in excess of rates of interest allowed to be charged by private parties in California. The measure of compensation to the State for delay in payment of unemployment taxes was fixed by the California Legislature in Section 45 of the Unemployment Reserves Act.

The California Legislature is unhampered by any constitutional limitation in fixing rates of interest on delinquent taxes. It may fix varying rates of interest on different kinds of taxes. Section 45 of the Cali-

fornia Unemployment Reserves Act is free from ambiguity and expressly denominates 12 per cent per annum as interest.

ARGUMENT

I.

INTEREST AT THE RATE OF 12 PER CENT PER ANNUM IMPOSED BY SECTION 45, CALIFORNIA UNEMPLOYMENT RESERVES ACT, ON DELINQUENT TAXES IS NOT A PENALTY IN BANKRUPTCY.

The sole question presented in this case is whether the 12 per cent interest on delinquent taxes provided for in Section 45 of the California Unemployment Reserves Act is allowable as interest in bankruptcy or whether the same constitutes a penalty not allowable under Section 57j of the Bankruptcy Act. (Title 11, U. S. C. A. Sec. 93j.)

There is a clear distinction between interest on the one hand and penalty on the other. As stated by this Court in *United States v. Childs*, 266 U. S. 304, a penalty is a means of punishment, while interest is a means of compensation for delay in payment. A penalty arises upon the act of delinquency; it arises but once. The amount thereof ordinarily is not reduced if the tax is paid shortly after delinquency. In other words, a penalty is a pecuniary punishment for an infraction of the law—failure to pay the tax on its due date—and the amount thereof ordinarily has no relation to the extent of the delay beyond the statutory period. Interest, on the other hand, is a continu-

ing obligation—it accrues upon the date of delinquency and continues as long as the tax remains unpaid. Its purpose is to compensate the State for the loss occasioned to it by the delay in payment.

In *United States v. Childs*, supra, this Court held that interest at the rate of one per cent per month imposed for delinquency in tax payment by the Revenue Act of 1916 did not constitute a penalty within the meaning of Section 57j of the Bankruptcy Act. After quoting from the opinion of the Circuit Court (*In Re J. Menist & Co.*, 290 Fed. 947 which was the *Childs* case below), holding such interest to be a penalty, this Court stated, at page 309:

> "We are unable to concur. It makes the rate of interest that of a particular locality, differing with the locality—in New York, as said by the government, 6 per cent; in the Middle West, 8 per cent; and on the Pacific Coast, 10 per cent—and abridges or controls a federal statute by a local law or custom, and takes from it uniformity of operation. Besides, the federal statute is precise, and it is made peremptory by the distinction between 'penalty' and 'interest' and if it may be conceded that the use of the latter word would not save it from condemnation if it were in effect the former, it cannot be conceded that 1 per cent per month—12 per cent a year—gives it that illegal effect, certainly not against legislative declaration that is within the legislative power, there being no ambiguity to resolve."
>
> * * * * * * *
>
> "The tax in this case is one on income; a burden imposed for the support of the government. In-

> terest is put upon it and so denominated, distinguished from the 5 per cent as penalty, clearly intended to compensate the delay in payment of the tax—the detriment of its nonpayment, to be continued during the time of its nonpayment—compensation not punishment."

This Court in distinguishing its decision in the *Childs* case from its earlier decision in *New York v. Jersawit*, 263 U.S. 493, had this to say at 266 U.S. 309:

> "To this conclusion New York v. Jersawit, 263 U.S. 493, 44 S. Ct. 167, 68 L. Ed. 405, is not antagonistic. There a statute of New York (Consol. Laws, c. 60) was passed on which required 'every domestic corporation' to 'annually pay in advance * * * an annual franchise tax' upon its net income for the year next preceding, and provided that, if the tax were not paid, the corporation should pay 'in addition to the amount of such tax * * * ten per centum of such amount, plus one per centum for each month the tax * * * remains unpaid.' This liability the lower federal courts pronounced a penalty and not to be allowed. In that conclusion this court concurred and decided that, being penalty, it was disallowed by Bankruptcy Act, Sec. 57j. And this not only because the 1 per centum was 'more than the value of the use of the money', but because it was added by the statute to the 10 per cent, to make a single sum, and 'must be treated as part of one corpus, and must fall with that.' "

It is important to observe that in the *Jersawit* case the statute provided for the payment by the taxpayer

of "ten per centum of such amount (annual franchise tax), plus one per centum for each month the tax remained unpaid." *The statute thus did not denominate the one per cent as being interest,* and this Court held that because the one per cent was added to the 10 per cent to make a single sum, it "must be treated as a part of one corpus, and must fall with that." But in the case now before the Court, the California Legislature clearly and expressly fixed an interest rate of 12 per cent per annum during the period of delinquency and it did not add or couple this interest with any penalty provisions, such as the 10 per cent and 15 per cent penalties set forth in Section 45.3 of the Unemployment Reserves Act, which provisions became effective September 19, 1939.

United States v. Childs, supra, so far as respondent can determine, has never been limited by any subsequent decision of this Court. On the contrary, it has been followed and cited with approval by the Second and Seventh Circuit Courts of Appeals, as well as by the Ninth Circuit Court in its opinion in the instant case below.

In the case of *In re Semon,* 80 Fed. (2d) 81, the Second Circuit Court held that interest at the rate of one per cent per month on delinquent taxes under the Revenue Act of 1928 did not constitute a penalty in bankruptcy. The Circuit Court stated, at page 82:

> "An interest rate of one per cent a month is not per se a penalty. United States v. Childs, 266 U.S. 304, 45 S. Ct. 110, 69 L. Ed. 299."

The *Childs* and *Semon* cases were followed in the case of *In re Beardsley & Wolcott Mfg. Co.* (2 C.C.A.), 82 Fed. (2d) 239, wherein it was held that interest at the rate of three-fourths of one per cent per month imposed by statute upon delinquent city real estate taxes did not constitute a penalty in bankruptcy.

In the case of *In re Martin* (7 C.C.A.), 75 Fed. (2d) 618, it was held that interest on unpaid taxes at the rate of one per cent per month imposed by the Illinois Motor Fuel Tax Act was not a penalty in bankruptcy. At page 621, the Circuit Court stated:

> "The matter of interest rates is within the power of the legislature. People v. Baldwin, 287 Ill. 87, 122 N.E. 148. We find nothing in the record to indicate anything grossly excessive or inequitable in the interest fixed by the statute and carried into the judgment, and we are not at liberty to disturb its allowance."

In the case of *In re Kallak* (D. C. North Dakota), 147 Fed. 276, decided in 1906, it was held that interest at one per cent per month on unpaid property taxes imposed by a state statute did not constitute a penalty in bankruptcy.

New York v. Jersawit, 266 U.S. 493, strongly relied upon by the petitioner throughout his brief, is so clearly distinguishable that it does not substantiate the contention of the petitioner in any respect. As pointed out above, this Court in the *Childs* case clearly distinguished its decision in the *Jersawit* case. Furthermore, the statute involved in the *Jersawit* case did not denominate any charge as *interest* on the delin-

quency of tax payments. It is illogical to argue that the *Jersawit* case and not the *Childs* case is controlling here because the former involved a state statute while the latter involved a federal statute. There is no valid reason why the measure of compensation for tax delinquencies should be higher to the Federal Government than to a State. Moreover, the California Legislature, like the Federal Congress, is unfettered by any constitutional limitation in fixing rates of interest on delinquent taxes.

As stated by the Ninth Circuit Court in its opinion below, the only decision of a Circuit Court of Appeals contrary to the respondent's contention is *In re Pressed Steel Car Co. of New Jersey* (3 C.C.A.), 100 Fed. (2d) 147. In holding interest at the rate of one per cent per month on state corporation franchise taxes to be a penalty, the Third Circuit Court relied solely upon the *Jersawit* case; the Circuit Court did not cite or distinguish the decision of this Court in the *Childs* case nor the decisions of the Seventh and Second Circuit Courts in the *Martin* and *Semon* cases and in fact assumed that the state would be content with simple interest for the issue was not sharply contested.

The case of *In re Ashland Emery and Corundum Co.* (D.C. Mass.), 229 Fed. 829, relied upon by petitioner at pages 10, 12 and 16 of his brief, was in effect overruled by this Court in *United States v. Childs*, 266 U.S. 304, 308, when it said in commenting upon the decision of the Circuit Court of Appeals in the case of *In re J. Menist and Co.*, 290 Fed. 947:

"The Circuit Court of Appeals adjudged the tax in the present case a debt and assigned against it interest at 6 per cent; the court considering that that interest was compensation for the delinquency anything in excess becoming penalty and within the prohibition of section 57j. The court said:

'On the point at bar (1 per cent interest as the price of the delay being penalty) we are in accord with In re Ashland, etc. (D.C.) 229 Fed. 829, and hold that, there being no evidence of any injury or damage to the government by the withholding of this tax, except that which flows from the nonpayment of a just debt, anything in excess of the legal rate of interest is to be treated as a penalty and not allowed.'

"We are unable to concur. * * *"

In the case of *In re 168 Adams Building Corporation* (D.C. Ill.), 27 Fed. Supp. 247, aff'd. 105 Fed. (2d) 704 (C.C.A. 7), cert. denied, 308 U.S. 623, also relied upon by petitioner on page 17 of his brief, the ruling of the District Court on interest was not contested on appeal and the opinion of the Seventh Circuit Court is entirely silent thereon. The respondent respectfully submits that had the Circuit Court's attention been directed to the matter of interest it would have followed its ruling in the *Martin* case, supra.

The decision of the District Court in the Second Circuit, in the case of *In re A. E. Fountain, Inc.* (D.C. N.Y.), 295 Fed. 873 (cited at page 18 of petitioner's brief), was in effect overruled by the later decisions of the Second Circuit Court in the *Semon* and *Beardsley & Wolcott* cases, supra.

The case of *In re Wells* (D.C. Md.), 4 Fed. Supp. 329, cited on page 18 of petitioner's brief is not in point, since there no claim was made for interest or penalties.

Petitioner, on page 19 of his brief, attempts to distinguish the case of *In re Martin* (7 C.C.A.), 75 Fed. (2d) 618, on the ground that the Court, in its opinion, failed to mention or discuss Section 57j. As pointed out by the Ninth Circuit Court in its opinion below, reference to the briefs in the *Martin* case shows that the appellant therein directed the Court's attention to Section 57j of the Bankruptcy Act. Nevertheless we submit that the Court in allowing interest at the rate of 1 per cent per month necessarily held that such rate of interest was not a penalty under Section 57j of said Act.

In this connection, it should be noted that the decision of the Second Circuit Court in the case of *In re J. Menist & Co.*, 290 Fed. 947, holding interest at one per cent per month to be a penalty in bankruptcy, was reversed by this Court on appeal in *United States v. Childs*, supra.

II.

THE LEGISLATURE MAY PROVIDE FOR INTEREST ON DELINQUENT TAXES AND MAY FIX THE RATE THEREOF.

While delinquent taxes do not bear interest unless so provided by statute, the legislature may provide therefor and may fix the rate in the absence of any constitutional limitation, of which there is none in the

Constitution of the State of California, 24 *California Jurisprudence* 296; *United States v. Childs,* 266 U.S. 304; *In re Martin* (7 C.C.A.), 75 Fed. (2d) 618; *In re Semon* (2 C.C.A.), 80 Fed. (2d) 81.

In Section 45 of the California Unemployment Reserves Act the legislature, presumably after consideration of all factors involved, fixed the measure of compensation to the State for delay in payment of unemployment taxes. The legislative intent and purpose should not be subverted by the Courts through the device of labeling a penalty that which the legislature has declared to be interest—certainly not where the legislative declaration is neither arbitrary nor unreasonable. As stated in the opinion of the Ninth Circuit Court below, "To fix a rate of interest other than that fixed by law would be a departure from the legislative mandate in the sphere in which the legislature is supreme."

From an inspection of the tax statutes in effect in California prior to the enactment of the California Unemployment Reserves Act, it cannot be doubted that the California Legislature was well aware of the distinction between interest and penalty; and it is to be presumed that the legislature had knowledge of the principles enunciated in the *Jersawit* and *Childs* cases. (*Chesapeake & Potomac Tel. Co. v. Manning,* 186 U.S. 238.) It was undoubtedly due to this knowledge that the legislature, when in 1939 it added the common 10 per cent negligence and 15 per cent fraud penalties to the Unemployment Reserves Act, placed such penalties in a separate section of the Act entirely apart from the

section providing for interest on delinquent tax payments. It is indeed *startling* that petitioner should in effect ask this Court to impute to the legislature some ulterior motive in providing this separability between the statutory interest and penalty provisions (see page 12 of petitioner's brief). A Court may not impute a particular intention to the legislature when nothing in the language employed implies such an intention.

It may be conceded that, as argued by petitioner on page 10 of his brief, a true penalty may not be converted into interest merely by calling it interest. On the other hand, while statutory nomenclature is not conclusive it is of probative force. *In re Beardsley & Wolcott Mfg. Co.* (2 C.C.A.), 82 Fed. 239. There must of necessity be a fundamental assumption that the language used in a statute expresses the legislative intent, particularly when, as here, that language is entirely free from ambiguity.

In the *Childs* case, this Court pointed out that the fixing of a rate of interest on delinquent taxes was a matter within the legislative power, and to construe Section 57j of the Bankruptcy Act so as to permit this statutory rate to be ignored would result in the substitution of a rate which would be dependent in each case upon the value of the use of money in different localities. Both of these observations apply with equal force in the instant case.

Here, the California Legislature, acting within its sphere of authority, has fixed a rate of interest on delinquent taxes and has denominated it as interest, and, as will be shown later herein, the Legislature has

fixed a rate of interest which is less than the maximum rate allowed to be charged by private parties in the State of California.

To depart from this rate of interest fixed by legislative mandate would result in a lack of uniformity of operation. As stated in the opinion of the Court below:

> "* * * for not only might a different rate be fixed in California, but different rates might be fixed in the same community by different referees in bankruptcy or by the same referee if in his judgment the value of the use of money had fluctuated from time to time in the community in which he was exercising his judicial functions."

The application of this principle of uniformity of interpretation is not limited to the State of California. Unemployment Insurance is a national program. Each of the forty-eight states, as well as Alaska, Hawaii, and the District of Columbia, has on its books an unemployment compensation statute. In thirty-eight jurisdictions the unemployment compensation statutes impose interest at the rate of one per cent per month on delinquent unemployment taxes. Accordingly, it is submitted that the reasoning of this Court in the *Childs* case is equally pertinent in the case now before the Court.

III.

THERE IS NO CONSTITUTIONAL LIMITATION UPON THE POWER OF THE CALIFORNIA LEGISLATURE TO FIX THE RATE OF INTEREST ON DELINQUENT TAX PERIODS. THE STATUTORY RATE OF INTEREST HERE INVOLVED IS NEITHER EXCESSIVE NOR INEQUITABLE.

At page 19 of his brief, petitioner contends that section 22, Article XX, of the California Constitution limits the power of the legislature to impose interest on delinquent tax obligations to seven per cent. It is submitted that a plain construction of Section 22 indicates clearly that the enactment is applicable to private parties and does not affect the state.

Section 22 sets up three catagories of obligations to which its inhibitions apply. These are:

> 1. "Upon the loan or forbearance of any money, goods or things in action * * * but it shall be competent for the parties to any loan or forbearance to contract in writing for a rate of interest not exceeding ten per cent per annum."
>
> 2. On accounts after demand.
>
> 3. On judgments rendered in any court of the State.

It is clear that delinquent taxes do not come within the first category. A tax is not founded upon contract and does not depend for its validity upon the individual assent of the taxpayer. It has long been held in California that a tax is not a debt due and does not establish a debtor-creditor relationship. 24 *California Jurisprudence* 21. Both loans and forbearances are premised on a contract or debtor-creditor

relationship. *Title Guaranty and Surety Co. v. Klein*, 178 Fed. 689.

With respect to the second category, Bouvier's Law Dictionary (Baldwin's Century Edition), page 33, defines account as: "A detailed statement of the mutual demands in the nature of debt and credit between parties, arising out of contracts or some fiduciary relation". Since an account is premised on a debtor-creditor relationship, and since a tax is not a debt and does not arise out of a contract or fiduciary relationship, it is submitted that the second classification imposes no inhibition on the legslative power to set interest rates on delinquent taxes.

With respect to the third category, it should suffice to say that a constitutional limitation of the rate of interest on judgments cannot be considered as an inhibition on the legislative power to set the interest rate on delinquent taxes. Judgments, including judgments for taxes, have borne interest at 7 per cent in California since 1868, independently of anything contained in section 22, Article XX. (Statutes of California, 1868, page 553; Civil Code, Section 1920, enacted March 21, 1872; superseded by Statutes of California, 1919, page lxxxiii.) Section 22, Article XX, on the other hand, was not enacted until 1934. However, the point is of no more than academic interest in the case now before this Court, since the tax claim here in issue has never been reduced to judgment.

Section 22 expresses itself fully on the matter of the interest rate permitted on numerous types of obliga-

tions. Nowhere does it speak on the subject of tax delinquencies. There are several thousand taxing agencies exercising their respective powers within the State of California. Surely, had the legislature intended section 22 to limit its power with respect to interest on delinquent taxes, it would have framed the enactment accordingly. With respect to petitioner's contention, the silence of section 22 on the subject of interest on delinquent taxes is peculiarly significant. That silence, it is submitted, compels the conclusion that no such limitation was intended.

It is well settled that in the absence of express words to the contrary neither the State nor any of its agencies or subdivisions is included within the general words of a statute. *Estate of Miller,* 5 Cal. (2d) 588, 597, 55 Pac. (2d) 491; 23 *California Jurisprudence,* page 625, Sec. 24; see also, *Dollar Savings Bank v. U. S.,* 19 Wall. 227, 86 U. S. 227. The rules of construction by which the meaning of language is to be ascertained are the same as respects constitutional or statutory provisions. *Winchester v. Mabury,* 122 Cal. at 527, 55 Pac. 393. At 16 *Corpus Juris Secundum,* page 140, section 70, it is stated that a state constitution is construed strictly in favor of the state, and as not divesting it or its government of any of its prerogatives, unless the intent to do so is clearly expressed. Therefore, it is to be concluded that section 22 of Article XX of the California Constitution in no wise limits the powers of the State legislature to fix the rate of interest on delinquent taxes, for nowhere in said constitutional provision is there an

expressed intention that the State shall be bound thereby.

It is to be noted that, at the time the Legislature in 1933 proposed Article XX, section 22 of the Constitution by Assembly Constitutional Amendment 79, during the same session, July 31, 1933, more than two months thereafter, the Retail Sales Tax Act was enacted (Statutes of California, 1933, p. 2599), and under section 22 thereof provided for interest at the rate of 12 per cent per annum on delinquent sales tax payments.

Again, the Personal Income Tax Act (Deering's Act 8494, section 15), from its enactment in 1933 until amended in 1935, provided for interest at the rate of one per cent per month on delinquent taxes.

Furthermore, the Bank and Franchise Tax Act (Deering's Act 8488, section 24) during the years 1931 to 1937, provided for interest on delinquent taxes at the rate of one per cent per month.

As pointed out herein, section 45 of the Unemployment Reserves Act (Chap. 352, Statutes of California, 1935) provided for interest at the rate of 12 per cent per annum on delinquent taxes.

This course of legislative conduct, which took place both before, during and subsequent to the submission of Assembly Constitutional Amendment 79, indicates clearly that the Legislature, in the language which it used in framing section 22, Article XX of the Constitution did not intend in any way to limit its power to fix varying rates of interest on delinquent tax payments.

Petitioner stresses the fact that the interest rate imposed by the Unemployment Reserves Act is in excess of the interest rate on unpaid judgments. (Petitioner's brief, page 19.) There is no basis in California legislative history for lumping the interest rate on unpaid judgments with that on unpaid taxes, or for applying the interest rate on judgments to delinquent taxes.

The interest rates on California taxes, have always been contained in the individual taxing statutes and have been and are calculated at varying rates. Interest on taxes, as distinguished from interest on judgments, has traveled an entirely separate statutory path. There is no basis in law or in fact for petitioner's contrary contention in this regard. Indeed, a survey of California state laws compels the conclusion that the interest rate on judgments has no connection whatsoever with the interest rate on unpaid taxes.

Petitioner contends that an interest rate in excess of that permitted to private persons is *ipso facto* a penalty as to the excess. (Petitioner's Brief, page 13.) Section 22, Article XX of the Constitution expressly exempts from its operation certain types of lenders such as building and loan associations, loan companies, credit unions, banks, and any duly licensed pawnbrokers and personal property brokers. The Legislature was given power to prescribe rates for the categories which were exempted from the constitutional limitation.

In California, credit unions may, by law, charge interest on loans at the rate of one per cent per

month. (Deering's Act 1887, section 3, subdivision 5.) Pawnbrokers may charge up to 2 per cent per month on the first $100 of indebtedness, and one per cent per month on anything above that amount. (Deering's Act 5826, section 2, as amended 1939.) Personal property brokers may charge interest at 2½ per cent per month on the unpaid balance not in excess of $100, and up to 2 per cent per month on the remainder. (Deering's Act 5825 (2d), section 17, as amended, 1939.)

Thus it will be seen that the interest provision here under attack is *not* in excess of the interest rate which California law permits many classifications of creditors to impose. It could hardly be maintained, for example, that the 2 per cent per month interest rate permitted to personal property brokers is in any sense a penalty. There is no more warrant for applying that label to the interest rate set up by the Unemployment Reserves Act.

In *Horn v. Boone County* (8 C. C. A.), 44 Fed. (2d) 920, the Court held that interest on delinquent taxes at 10 per cent per annum did not constitute a penalty in bankruptcy, inasmuch as the state (Nebraska) permitted private parties by agreement to fix a rate of interest as high as 10 per cent. As so aptly stated by the Ninth Circuit Court of Appeals in its opinion below:

> "If this rule be applied in California it would follow that 12 per cent is not a penalty because the laws of California permit an even higher rate than 12 per cent per annum with reference to certain types of loans."

In fixing the rate of interest here involved, the legislature undoubtedly had in mind the peculiar nature and purpose of the taxes levied by the statute. These unemployment taxes differ substantially from ordinary taxes; instead of being deposited in the general fund of the state, these taxes go into a special fund to be used *only* for the payment of benefits to qualified unemployed workers. Such taxes are not public funds in the sense that they are subject to appropriation for general state purposes. The California Unemployment Reserves Act provides for no lien to protect the collection of these taxes. The timely payment of these contributions is necessarily essential to the maintenance and success of the unemployment insurance program. The legislature, in fixing interest at the rate of 12 per cent per annum as the measure of compensation to the state for the loss occasioned by the delay in payment of contributions, must be assumed to have had in mind all of the circumstances and factors above discussed.

CONCLUSION.

It is respectfully submitted that the authorities cited and relied upon by respondent, and in particular the *Childs* case, clearly established the proposition that interest on delinquent unemployment taxes at the rate of 12 per cent per annum, as prescribed in section 45 of the California Unemployment Reserves Act, does not constitute a penalty within the meaning of section 57j of the Bankruptcy Act, such rate

being neither excessive nor unreasonable and not higher than the rate of interest allowed to be charged by private parties in the State of California.

Upon the foregoing considerations and authorities the decision of the Ninth Circuit Court of Appeals should be affirmed.

Dated, Sacramento, California,
December 5, 1941.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 61.—October Term, 1941.

Harry F. Meilink, as Trustee in Bankruptcy of the Estate of United Lamp & Shade Corporation, Bankrupt. *vs.* Unemployment Reserves Commission of the State of California.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[January 5, 1942.]

Mr. Justice Jackson delivered the opinion of the Court.

The petitioner is the trustee of a bankrupt which was indebted to the California Unemployment Reserves Commission for contributions which had accrued under the California Unemployment Reserves Act. Section 45 of that Act provided that in the event of default in payment of contributions due the employer "shall become additionally liable for interest on such payments at the rate of twelve per cent per annum from the date such payment becomes due, both principal and interest being payable in the same manner as the contributions." Deering's Cal. Stats. 8780d, § 45. The Commission filed proof of a priority claim in the bankruptcy proceeding for the principal amount of the accrued contributions and interest thereon at the rate of twelve per cent.

The trustee paid the principal sum with interest at six per cent, but refused to pay more, relying on § 57j of the Bankruptcy Act, 11 U. S. C. § 93j, which provides that "Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law." The trustee asserted that any exaction in excess of six per cent, which he claimed was the "reasonable and customary rate of interest," was a penalty; the bankruptcy court decreed that all above seven per cent a common,

though not an invariable, legal rate in California) was a penalty and refused to allow so much of the claim; and the Circuit Court of Appeals for the Ninth Circuit reversed on the ground that no part of the twelve per cent was a penalty. 116 F. 2d 330. We granted certiorari because of the conflict between this decision and that of the Circuit Court of Appeals for the Third Circuit in *In re Pressed Steel Car Co. of New Jersey.*[1]

Petitioner seeks to establish that the twelve per cent exaction here in question is not "interest" by pointing to Article XX, Section 22 of the California Constitution, which provides that, except for specified institutions, the rate of interest on loans, and on accounts after demand or judgment, shall be seven per cent, and leaves the parties free to contract in writing for a rate not exceeding ten per cent.[2] We do not understand that as a matter of State law the California legislature was thereby forbidden to prescribe the higher rate here involved. And the mere difference in rates does not establish that the twelve per cent rate is not "interest" within the meaning of § 57j of the Bankruptcy Act.

It is common knowledge that interest rates vary not only according to the general use value of money but also according to the hazard of particular classes of loans. Delinquent taxpayers as a class are a poor credit risk; tax default, unless an incident of legitimate tax litigation, is, to the eye sensitive to credit indications, a signal of distress. A rate of interest on tax delinquencies which is low in comparison to the taxpayer's borrowing rate—if he can borrow at all—is a temptation to use the state as a convenient, if involuntary, banker by the simple practice of deferring the payment of taxes.

Another variable is the amount necessary to compensate for the trouble of handling the item. The legislature may include compensation to the state for the increased costs of administration in

[1] 100 F. 2d 147, certiorari denied *sub. nom.* Wick et al. v. New Jersey, 306 U. S. 648.

[2] This reads in part as follows:

"The rate of interest upon the loan or forbearance of any money, goods or things in action, or on accounts after demand or judgment rendered in any court of the State, shall be seven per cent per annum but it shall be competent for the parties to any loan or forbearance of any money, goods or things in action to contract in writing for a rate of interest not exceeding ten per cent per annum."

Expressly excepted are building and loan associations, industrial loan companies, credit unions, pawnbrokers, personal property brokers, State and National Banks, and cooperative associations.

the exaction for delay in paying taxes without thereby changing it from interest to penalty.

These factors—risk, and the expenses of handling—are reflected in the interest rates permitted by California to certain types of financial institutions: for example, credit unions may charge interest at the rate of one per cent per month;[3] pawnbrokers, at two per cent per month on the first one hundred dollars of indebtedness;[4] and personal property brokers, two and one-half per cent per month on the first three hundred dollars.[5] A differentiation of treatment for particular types of loans similar in principle is commonly made by other states.[6]

New York v. *Jersawit*, 263 U. S. 493, is thought by petitioner to require a decision in his favor. That case involved a New York statute visiting tax delinquents with an additional liability of ten per cent of the tax, and adding thereto a further liability of one per cent per month, which was not denominated interest. The Circuit Court of Appeals had held that such provision was penal, but had allowed interest at the usual legal rate on the theory that it represented actual damage. *In re Ajax Dress Co.*, 290 F. 959. This Court, speaking through Mr. Justice Holmes, said:

"There can be no doubt that the additional ten per centum charged for failure to pay by January 1 is a penalty, disallowed by the Bankruptcy Act, § 57j, but it is urged that the one per centum for each month of default is statutory interest and that the State is entitled to that and otherwise would be entitled to none. As the one per centum is more than the value of the use of the money and is added by the statute to the ten to make a single sum it must be treated as part of one corpus and must fall with that. We presume that in this event the State does not object to receiving the simple interest allowed. That part of the order will stand." 263 U. S. at 496.

Here the exaction computed according to lapse of time is not lumped together with another percentage computed without reference to lapse of time; here the exaction is denominated interest by the statute, and there it was not; and we cannot be so confident here that twelve per cent "is more than the value of the use of the money," or of the validity of the implied major premise

[3] Deering's Cal. Stats. 1887 § 3(5), as amended, 1939.

[4] Deering's Cal. Stats. 5826 § 2, as amended, 1939.

[5] Deering's Cal. Stats. 5825(2d) § 17, as amended, 1939.

[6] Clark, Financing the Consumer (1933), Appendix I.

that an exaction in excess of such value cannot be merely an interest charge.[7]

The decision which controls here is the more recent one of *United States* v. *Childs*, 266 U. S. 304, where the statute separately denominated a flat five per cent exaction as a penalty, and an additional one of one per cent a month as interest. The latter was held to be "interest" within the meaning of § 57j of the Bankruptcy Act. The distinction from the fact that the exaction in that case was by the United States and in this case by a State calls for no difference in result. We must give credit to a state legislature acting within its Constitutional sphere like that accorded to Congress acting in its Constitutional sphere. And the distinction which Congress made in the legislation considered in the *Childs* case and in other revenue legislation between penalty as a fixed *ad valorem* amount taking no account of time, and interest which does depend on time, is persuasive that its use of the word "penalty" in the Bankruptcy Act will bear a like differentiation from interest.

Finally, it may be observed that Congress itself has provided in the District of Columbia Unemployment Compensation Act that in the event contributions are not paid when due "there shall be added, as part of the contributions, *interest* at the rate of 1 per centum per month." (Italics supplied.) D. C. Code (Supp. V, 1939) tit. 8, § 314(e).

Affirmed.

Mr. Justice ROBERTS took no part in the decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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[7] Compare the following exactions, provided by the various Unemployment Compensation Acts for non-payment of contributions due:

"Interest" at 6% per annum or its equivalent on a monthly basis: United States, Delaware, Florida, Georgia, Indiana, Massachusetts, New York, North Carolina, Oregon, Utah, Wisconsin; at 8%: Ohio; at 81/100% per month: Kansas; at 9%: Connecticut, Michigan; at 12%: District of Columbia, Alabama, Arizona, Arkansas, Colorado, Illinois, Iowa, Louisiana, Maine, Maryland, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Dakota, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Vermont, Virginia, Washington, West Virginia, Wyoming.

"Penalty" at 12%: Kentucky, Texas; at 2% to 25% per month: Idaho.